Section 3　Building an international industrial structure for market creation

As described in Section 2 of this chapter, Japanese industries have been further advancing their globalization in recent years. However, according to the discussion in Chapter 1, the competitive environment surrounding Japanese companies has intensified, as the role of the "Greater Asian Market" as a global growth engine has grown, and due to impacts from European and US companies' strategic initiatives and increased competitiveness of emerging countries.

On the other hand, as discussed in Section 1, Asia, in which Japanese companies have developed networks of manufacturing bases, is expected to develop into a large-scale economic zone that serves as a "huge consumer market" and a "powerful knowledge-creation base."

Under these circumstances, Japanese industries are forced to reconsider the ways in which they should develop international business developments in Asia and other areas.

In this Section 3, we will discuss how Japanese companies should build their international business networks, including how they can proactively provide goods and services that meet the needs of customers from local communities for the creation of new markets, in particular, the "Greater Asian Market;" how they can take advantage of those new markets as centers for innovation; and research and development.

First, we will (1) verify the current condition of the global competitive environment surrounding Japanese companies, which have developed overseas business operations, using survey results and other information, and discuss how they should configure their global value chains. We will then (2) discuss the significance of international business development by "domestic market oriented" industries such as the distribution and infrastructure intensive industries, and how this development should be undertaken. Finally we will (3) discuss the pioneering efforts in their international business development by small- and medium-sized enterprises along with risks involved.

1. Current condition of the global competitive environment surrounding Japanese companies

The success of companies' global expansion of value chains is closely linked to local consumer trends and the manner in which local management resources are used. Considering this aspect, we will examine whether Japanese companies are successfully expanding business operations in the emerging countries compared with their foreign competitors, and whether they are effectively utilizing local management resources. We will also consider the issues involved in the Japanese companies' global business development.

(1) Japanese companies' global business development

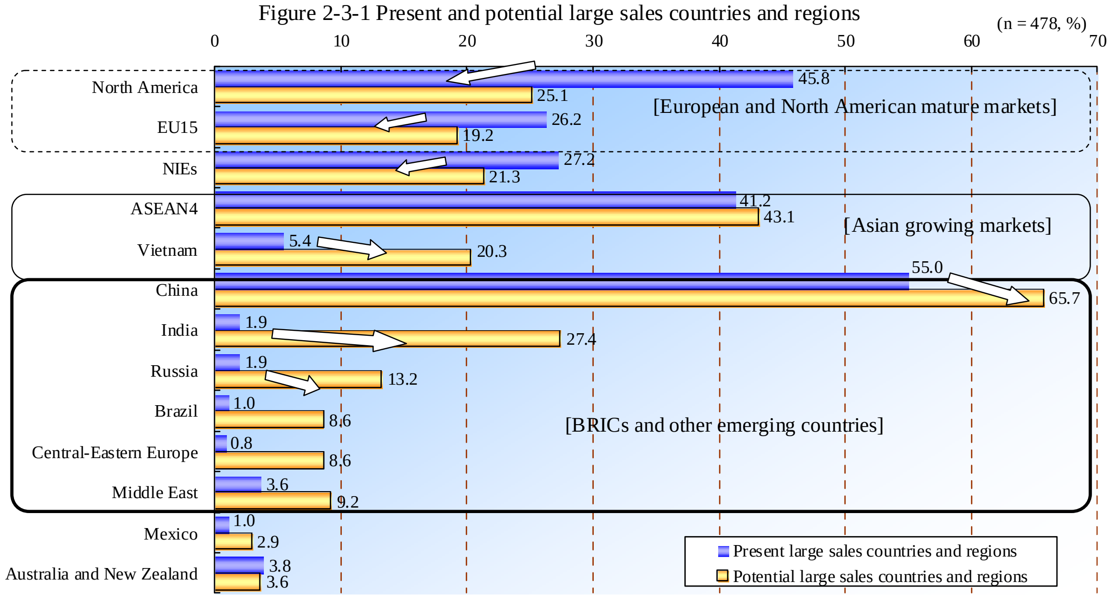
(Japanese companies expect sales growth in the emerging countries' markets)

According to the survey conducted by the Japan Economic Foundation[1], Japanese companies operating overseas expect a greater sales increase in high potential growth markets in many emerging

[1] The Japan Economic Foundation (2008), "*GLOBALIZATION GA SEKAI OYOBI NIHON KEIZAI NI ATAERU EIKYOU NI KANSURU CHOUSA KENKYU*". Please refer to Supplementary Note 2-2 for details of the survey.

countries and regions such as BRIC (China, India, Russia, and Brazil), Vietnam, ASEAN4, Central and Eastern Europe, and the Middle East than in the European and US developed countries' markets (see Figure 2-3-1).

Figure 2-3-1 Present and potential large sales countries and regions



Notes: NIEs comprises Singapore, Taiwan, Republic of Korea, and Hong Kong. ASEAN4 comprises Malaysia, Thailand, the Philippines, and Indonesia. EU15 comprises the U.K., Germany, France, Italy, Netherlands, Belgium, Greece, Luxembourg, Denmark, Spain, Portugal, Austria, Finland, Sweden, and Ireland.
Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies*

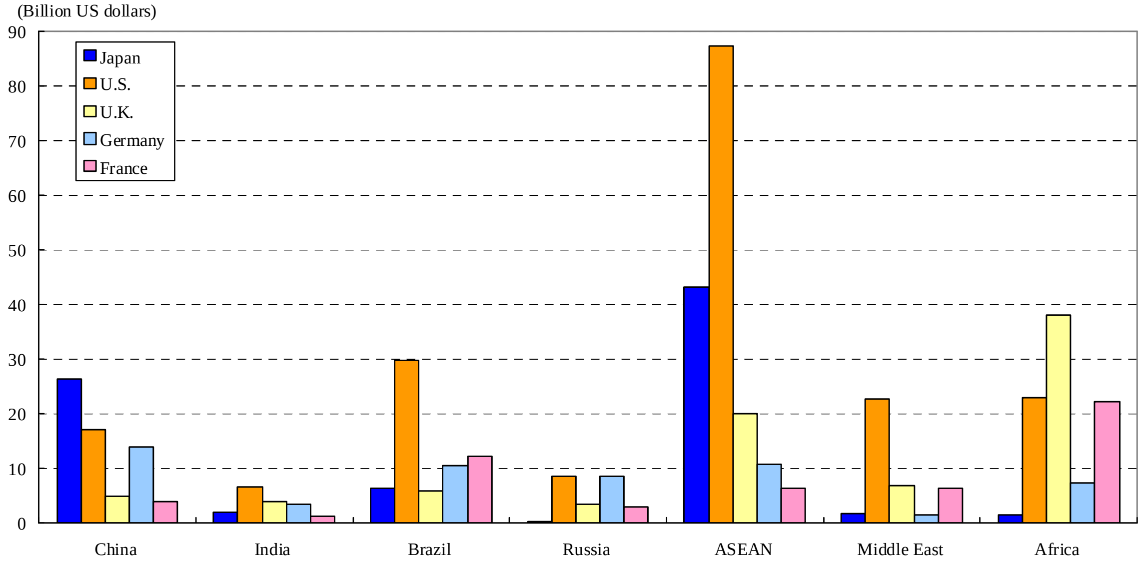
(Japanese companies are lagging behind their European and US counterparts in their international business development)

However, it cannot be said that the international business development by the Japanese companies has made considerable progress relative to the size of the economy. Comparing the ratios of foreign direct investment to GDP, that of Japan is seen to be significantly lower than those of other developed counties[2], although the outstanding balance of foreign direct investment from Japan has grown.

Moreover, considering the balance of foreign direct investment in the emerging countries from the major developed counties, we see that the investment from Japan has been heavily concentrated in China and ASEAN regions (see Figure 2-3-2). Japanese investment in other areas such as India, Russia, Brazil, and the Middle East is relatively smaller than those from the United States and the United Kingdom in the same areas. Moreover, in ASEAN countries, which are geographically close to Japan, the balance of investment from the United States is greater than that of Japan. Japanese investment in China is the greatest; however, the United States and the United Kingdom have been aggressively investing in China as well

[2] OECD (2007a), *Staying Competitive in the Global Economy*

Figure 2-3-2 Balance of direct foreign investment in emerging countries from major developed counties



Note: Definitions of ASEAN, the Middle East, and Africa are as defined by each country.
Sources: Institute for International Trade and Investment, *Statistics on direct foreign investment by major developed countrie*; Eurostat (France only).

(Rise of companies from emerging countries)

In addition, companies from emerging countries such as Taiwan, Republic of Korea, and China have developed their global value chains in recent years, increasing their competitiveness substantially. Overseas business developments by these emerging countries became active in the 1990s. Examining the trend in the growth ratio of the foreign direct investment balance, that of Japan was overall higher until the late 1980s; however, it was reversed around 1990 and since then, those of emerging countries have been generally higher than that of Japan[3].

Through overseas business development, companies from emerging countries have been steadily expanding their consumer base. Looking at each country's share in the total final goods exported to emerging countries, that of Japan fell 3.3% from 17.3% to 14.0% between 2001 and 2006, while China and Republic of Korea increased their shares by 3.2% and 1.7%, respectively[4].

As seen above, although Japanese companies are striving to expand their business in the emerging countries' markets, other developed and emerging countries have been more aggressively engaged in global business development activities. As a result, Japanese companies are facing increasingly intensified competition in the overseas markets.

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3 UNCTAD, "WIR Annex Tables"
4 Research Institute of Economy, Trade and Industry, "RIETI-TID2007"

[Column 9] South Korean companies' global business development

(More aggressive foreign direct investment than Japanese companies)

South Korean companies in the electrical, electronics, and automotive industries have been aggressively investing in the overseas markets, competing fiercely with Japanese companies in every market around the world.

Foreign direct investment from Republic of Korea has been sharply increasing since the end of the 1980s. Some experts pointed out four factors behind this increase: (1) capital accumulated in the country due to the savings ratio exceeding the investment ratio, (2) loosening of the foreign exchange control policy in response to increased trade surplus, (3) increased need for structural adjustments due to labor shortage and labor cost increase, (4) deteriorated export environment (exchange rate appreciation pressure, intensified trade friction, and the end of the Generalized System of Preferences in the United States)[5].

After the Asian Financial Crisis in July 1997, South Korea's foreign direct investment declined sharply. However, as a result of efforts to recover the economy through promoting exports taking advantage of its depreciated currency, its foreign direct investment started to grow again in 2000.

The significant changes observed after the Financial Crisis are the country's reduced direct investment in the ASEAN4 countries, which were previously the primary investment targets, and the increased investment in China; it also led to a rapid increase in direct investment in areas other than Asia, such as European and US countries, and Central and South American countries[6]. The former changes are considered to be caused by the country's strategy to increase its price competitiveness taking advantage of China's low production cost, and the latter changes are considered to be brought about by the internationally competitive companies' strategies to strengthen their business base and enhance their earning capabilities. Looking at South Korea's foreign direct investment in the emerging countries' markets from 2001 to 2006 by country, larger increases were seen in China, ASEAN, India, Central and Eastern Europe, Russia, Central Asia, etc.

Other factors behind South Korean companies' aggressive overseas business development include the fact that the country's population is less than 50 million and the domestic market is not sufficiently large, and that Republic of Korea experienced the Asian Financial Crisis, which placed the country under IMF supervision.

(Initiatives of Samsung Electronics, an electrical and electronics industry company)

The initiatives of Samsung Electronics, an electrical and electronics industry company, are introduced below.

Samsung Electronics has taken aggressive steps in establishing business operations in emerging countries such as Central and Eastern European countries and CIS (Commonwealth of Independent States) countries, where Japanese companies were not doing much business. The company entered those regions at a very early stage when competition was not yet severe, with a strategy to quickly

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5 Kitamura K. (2002), *ASIA NIES NO TAIGAI CHOKUSETSU TOUSHI*

6 Kitamura K. (2002), Same as above.

capture a large market share before others entered the market.

For example, the company entered the Russian market to establish its mobile phone business before any other of its competitors did. In 2003, Samsung Electronics undertook aggressive advertising and promotion initiatives to build its brand awareness, which included the establishment of a showroom in the central district of Moscow and the provision of support for a local ballet troupe. Due to these efforts and other factors, the company gained the top market share in the Russian mobile phone market in 2004.

○ Initiatives to build brand awareness

With the understanding that it cannot sustain long-term competitiveness by counting on low-end products, Samsung Electronics has been undertaking measures to build its brand awareness aiming to enhance the added value of products. One of the company's focus areas to strengthen brand awareness was the product design. The design sections, which were traditionally placed under every product development department, were integrated into newly established design centers. The design centers are located in key cities around the world, and they work closely with the headquarters in Republic of Korea. This move enabled Samsung Electronics to create designs that better and accurately reflect consumer trends in the marketplace. Moreover, the company has also enhanced its brand image by such activities as offering sponsorship to the Olympic Games and other sporting events, and promoting "famous spot marketing" in which a large-size advertising signboard is put up at popular and highly visible locations with heavy flow of traffic, in various locations throughout the world.

These brand building efforts have produced notable results. According to the survey results of consumer perceptions on each country's products, Korean products were ranked among the top groups in the "products with a lively and vigorous image" category (Column Figure 9-1). In some locations, the Korean products were ranked higher than Japanese products.

Column Table 9-1 "Products with a lively and vigorous image" category

	Hong Kong	Taipei	Seul	Bangkok	Mumbai	Shanghai	Moscow	Frankfurt
1	Korean products (70.3%)	Japanese products (62.3%)	Korean products (27.4%)	Japanese products (34.0%)	Korean products (20.2%)	Chinese products (36.5%)	Korean products (29.6%)	Japanese products (28.5%)
2	Chinese products (50.6%)	Korean products (56.6%)	American products (22.1%)	Korean products (27.4%)	Chinese products (14.1%)	Korean products (33.9%)	Chinese products (28.6%)	European products (25.2%)
3	Japanese products (48.5%)	European products (49.8%)	European products (21.5%)	American products (24.1%)	Japanese products (11.4%)	American products (32.5%)	European products (16.8%)	Chinese products (20.5%)
4	European products (41.8%)	American products (41.6%)	Japanese products (19.1%)	European products (23.5%)	American products (11.1%)	European products (32.0%)	American products (14.4%)	American products (16.9%)
5	American products (32.8%)	Chinese products (16.0%)	Chinese products (8.0%)	Chinese products (19.8%)	European products (9.6%)	Japanese products (28.4%)	Japanese products (14.2%)	Korean products (13.2%)

Source: Hakuhodo (2008), "Hakuhodo Global HABIT 2007"

○ Human resources development

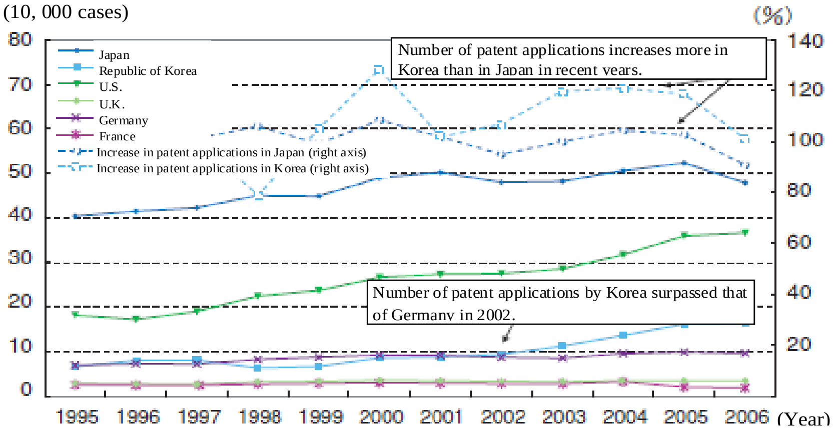
Samsung Electronics established a foreign market specialist training system in 1990 as part of its human resources development program. This system aims to train specialists who have in-depth knowledge of foreign markets and enhance the company's marketing capabilities. A trainee in this training system is allowed to stay in an overseas potential market area for a year. While actually living in the area, he or she focuses on learning about the local history, culture, and potential customers' tastes in order to become an expert of the potential market. Samsung Electronics is striving to strengthen its marketing capabilities through such human resources development activities as described above.

In addition, after the Asian Financial Crisis, the company started to promote global human resources development activities including a management training program for foreign-based foreign executives at the headquarters.

(Enhancing research and development capabilities)

South Korean companies have substantially improved their research and development capabilities as well. The number of patent applications filed by South Korean companies has been increasing in recent years (see Column Figure 9-2). It surpassed that by German companies in 2002.

Column Figure 9-2 Transition of number of patent applications by each country



Note: Tally of number of patent applications in Japan and abroad by type of nationality of applicants/Including PCT applications.

(Gap between large companies and small- and medium-sized companies)

In Republic of Korea, while large companies such as Samsung Electronics have successfully enhanced their business performance through aggressive overseas business development, small- and medium-sized companies are lagging behind in this regard. The gap in the earnings ratio between large companies and small- and medium-sized companies in Republic of Korea was about 5% in 2004, which was greater than that in Japan.

Some experts point out that the industrial structure in Republic of Korea developed with the support from Japan including the implementation of Japanese technologies, and manufacturing equipment and the development of domestic parts and raw materials industry is lagging behind[7]. This is considered to have caused the gap in the earnings ratio between large companies and small- and medium-sized companies in Republic of Korea.

Although the gap between large companies and small- and medium-sized companies is an issue as described above, there have been interesting and evocative examples in Republic of Korea such as the case of Samsung Electronics, where the rapid growth was achieved by incorporating management resources from around the world.

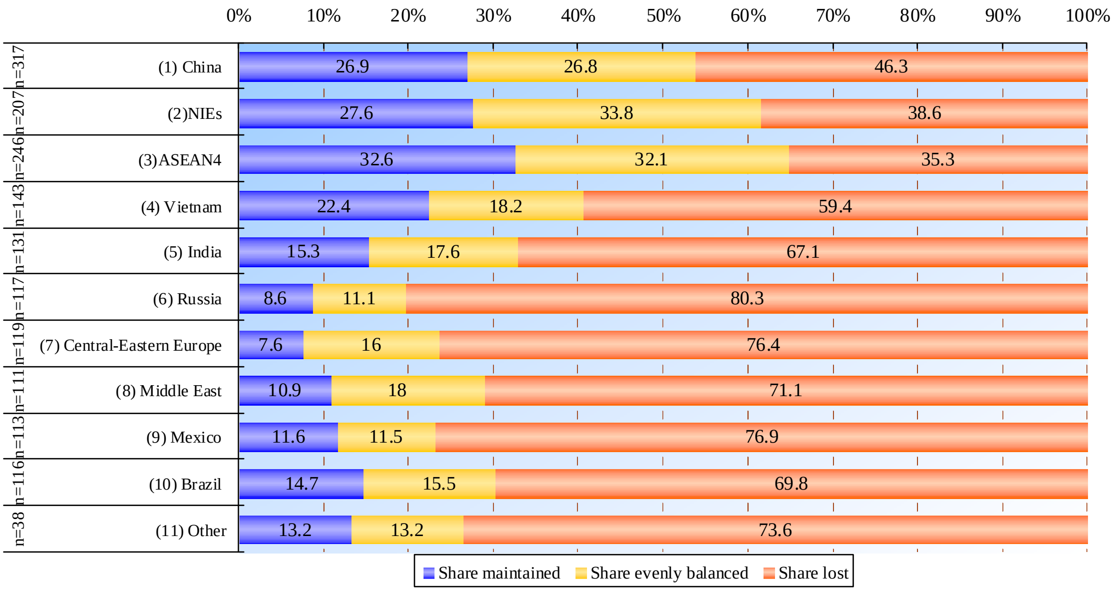
[7] Kubota T. (2004), "CHUUSHOU KIGYOU KOKUSAIKA SHIEN REPORT CLOSE UP ARATANA KYOKUMEN WO MUKAETA KANKOKU BUSINESS TO CHUUSHOU KIGYOU"

(Japanese companies are struggling to maintain their market share in the emerging countries)

As mentioned above, Japanese companies recognize the importance of their business development into markets of emerging countries whose GDPs are growing rapidly. The important issue for them is to develop value chains keeping pace with the growth of the emerging countries' markets for increasing their corporate value and for establishing solid earning foundations.

However, most Japanese companies are struggling to maintain their market shares in competition with their foreign counterparts in the emerging countries' markets. In the markets in China, NIEs and ASEAN4, about 30% of the Japanese companies claim that they are maintaining their market shares; whereas in all other countries and regions, the percentage of companies claiming that they were losing shares was the greatest (see Figure 2-3-3).

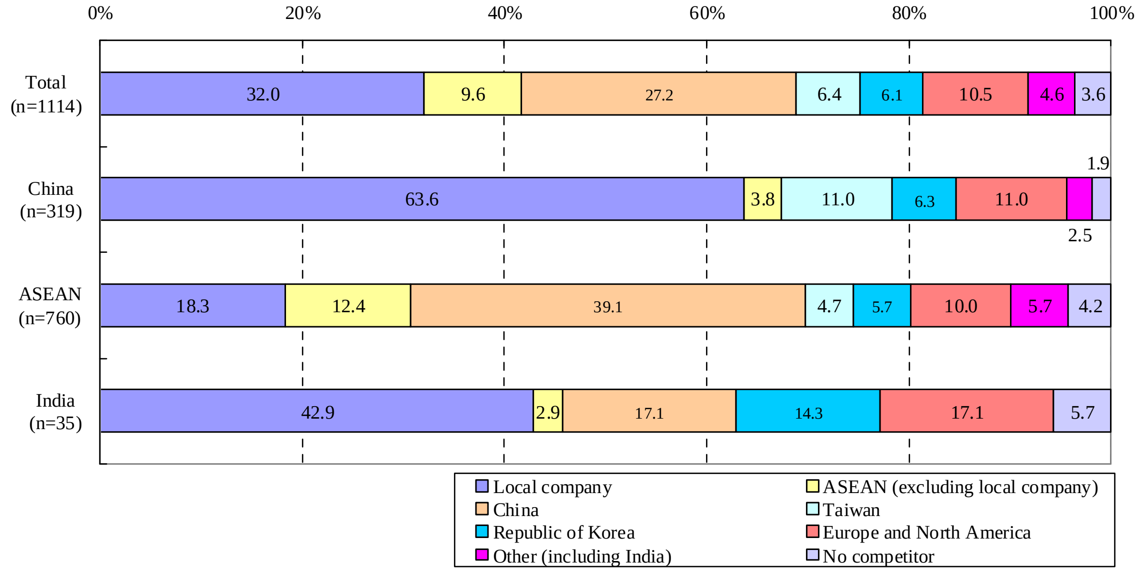
Figure 2-3-3 Japanese companies' share in emerging countries' markets compared with those of foreign companies



Note: Percentage calculated with the total number of responses for each country and region being the denominator.
Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies*.

The competitors are not just European and US companies. In the ASEAN markets, Chinese companies are the major competitors and in the Indian market, regional enterprises are the main competitors. Companies from emerging countries have shown themselves to be competitors (see Figure 2-3-4).

Figure 2-3-4 The strongest foreign competitor as a product distributer in the emerging countries' markets



Note: ASEAN comprises Thailand, Malaysia, Singapore, Indonesia, Philippines, and Vietnam.
Sources: JETRO (2007), *Survey of Japanese Manufactures in ASEAN and India (2006)*.
JETRO (2007), *Survey of Japanese Manufactures in China, Hong Kong, Taiwan and South Korea (2006)*.

(2) Issues in Japanese companies' business development by value chain function

What is required, then, for Japanese companies to maintain their market shares in the fast-growing emerging countries' markets, to enhance corporate value and increase revenue in the intensifying competitive environment? In the following section, we will review Japanese companies' overseas business development in each function area of the value chain, namely, "research and development," "manufacturing," and "sales."

(The "research and development" function, which requires the consideration of a shift to open innovation)

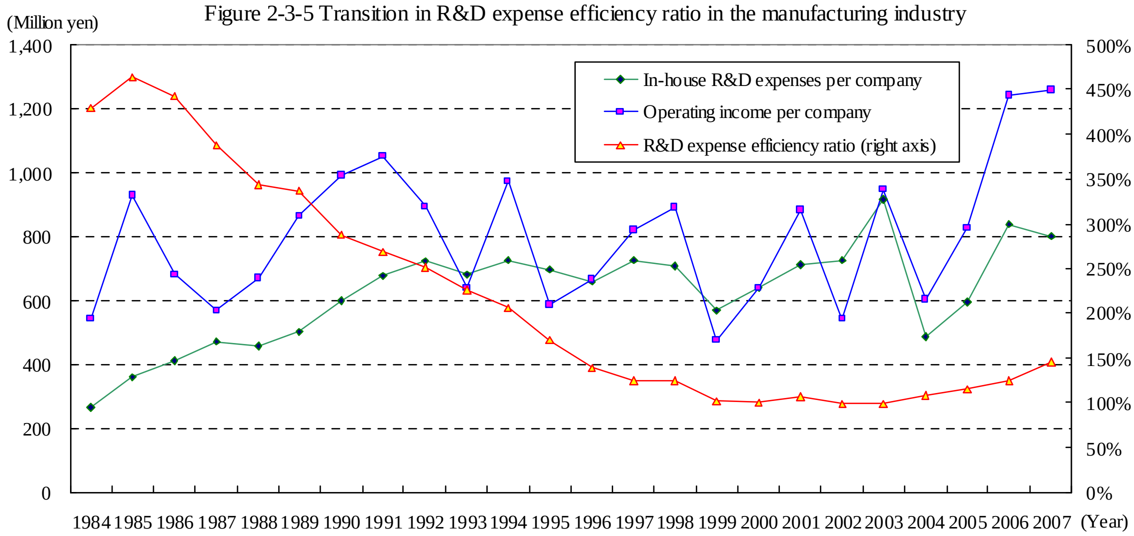
The research and development capabilities of Japanese companies are globally at the top level. For example, the number of patent applications is the highest in the world. Considering the relationship between the ratio of net export to GDP in Japan and different types of capital stock in Japan, we see that intellectual capital has been the driving force behind the export increase[8]. Moreover, based on the international comparison of the ratios of research and development expenses to GDP, those of Japan are seen to be higher than those of other developed countries. While those of European and US countries remain unchanged, Japan's ratios are on the increase[9]. Although China's ratio has increased significantly since 1995, it is still about two percentage points less than that of Japan.

However, it might be possible that Japan's efficiency in research and development is decreasing. Considering the ratio of operating income to the research and development expenses during the preceding five years, in the short term, this ratio has been increasing along with the recent increase of

[8] Supplementary Note 2-3. "Verification of the Heckscher-Ohlin theory by the element's content and regression analysis approaches"
[9] OECD (2007b), *Science, Technology and Industry Scoreboard 2007*.

the operating income; however, in the long term, it has been declining (see Figure 2-3-5).

Figure 2-3-5 Transition in R&D expense efficiency ratio in the manufacturing industry

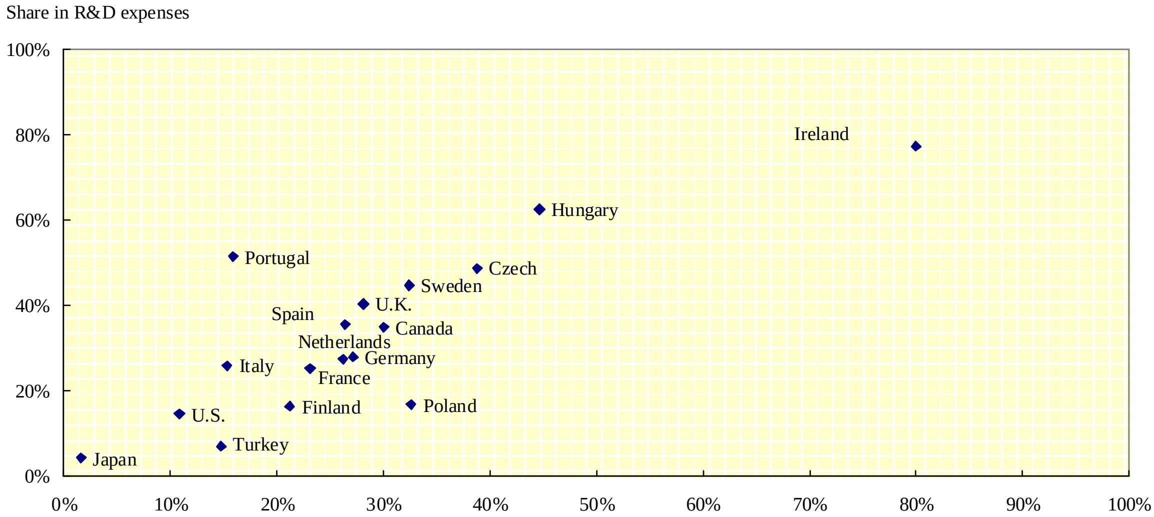


Notes: 1. Referred to Ministry of Education, Culture, Sports, Science and Technology (2003) Annual Report on Promotion of Science and Technology, Fiscal year 2002.
2. Used return (operating income) on R&D expense to measure R&D expense efficiency, assuming a lead time of five years.
The formula is as follows.
R&D expense efficiency ratio for the year = Operating income during the preceding five years / In-house R&D expenses during the preceding five years
Source: Statistics Bureau, Ministry of Internal Affairs and Communications, *Survey of Research and Development.*

The causes behind this R&D expense efficiency decline are considered to include the intensified global competitive environment and the higher per product R&D expense reflecting the increased need for more advanced technologies. One possible solution to this problem is open innovation[10]. However, Japanese companies might be lagging behind in implementing the open innovation strategy. The facts that support this are as follows: the extremely small shares of overseas subsidiaries in the total net sales or R&D expenses in Japanese companies compared with those in companies from other developed countries (see Figure 2-3-6) and the low number of collaboration projects with outside research and development firms (see Figure 2-3-7).

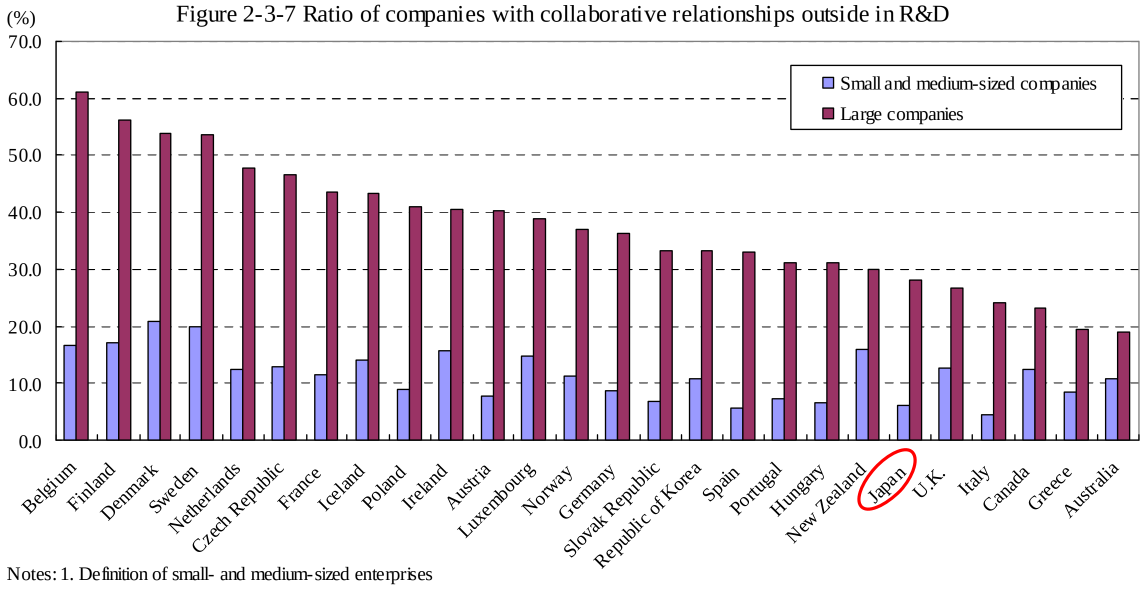
[10] In the open innovation model, companies undertake initiatives such as collaborative research and development with other firms to improve their research and development efficiency and to actively incorporate their technologies and knowledge; launching new businesses by obtaining license from other companies; transferring or provide license of intellectual property rights, which cannot be used by themselves, to other companies; creating a new market with international standards where participating companies share and utilize their intellectual property rights. As factors behind the increased need for the open innovation approach, the Council on Enhancing Competitiveness through Intellectual Property under the Intellectual Property Strategy Headquarters pointed out shortened product cycles due to quicker changes in customer needs, higher R&D and facility investment costs due to the increased need for more advanced and complex technologies, and enhanced areas of application for useful knowledge and technologies, which became available owing to the development of IT technologies.

Figure 2-3-6 Share of foreign companies in total R&D expenses and net sales in OECD countries



Notes: 1. Figures for the U.S., Japan, Germany, Ireland, Netherlands, Sweden, and Hungary are based on 2003 data.
2. Figures for Portugal and Turkey are based on 2001 data.
3. Figures for Germany, Ireland, Portugal, Spain, and Turkey are from the manufacturing industry only.
Source: OECD (2007b), *Science, Technology and Industry Scoreboard 2007.*

Figure 2-3-7 Ratio of companies with collaborative relationships outside in R&D



Notes: 1. Definition of small- and medium-sized enterprises
Number of Employees: 10–249 (Europe, Australia and Japan); 10–99 (New Zealand); 10–299 (Republic of Korea); 20–249 (Canada)
2. Surveys conducted between 2002 and 2004 (used the most recent data available for some countries)
3. The figure for Canada is from the manufacturing industry only.
Source: OECD (2007), *Science, Technology and Industry Scoreboard 2007.*

In addition, there is also little inflow of highly qualified researchers undertaking research and development activities in Japan[11]. The ratio of inventions made overseas and owned by Japanese companies is also low[12]. This implies that Japanese companies perform most of their research and development activities in Japan and are lagging far behind in incorporating foreign, highly qualified research and development resources and achievements. Moving on, one of the key issues for

[11] The status of acceptance of foreign highly qualified human resources by Japan is described in Section 1 of this Chapter.

[12] OECD (2007b), *Science, Technology and Industry Scoreboard 2007.*

improving the research and development efficiency of Japanese companies is utilizing foreign, highly qualified research and development resources.

(In "manufacturing capabilities," companies in emerging countries are catching up with Japanese companies)

Japanese companies have a competitive advantage in their high quality products and services. However, in recent years, companies in emerging countries, in particular in China, Republic of Korea, and Taiwan, where manufacturing industries have been prosperous, have greatly improved their product quality, catching up with the Japanese companies in the product quality.

In the past, although Chinese, Republic of Korean and Taiwanese products had competitive price advantages, Japanese products had competitive advantages in quality. However, South Korean and Taiwanese companies in particular have successfully enhanced their product quality. According to the results of the survey conducted on Japanese companies, 16.9% of the respondents in the high added value products category and 32.6% in the general purpose products category stated that South Korean and Taiwanese products were comparable in quality and less or similar in price (see Figure 2-3-8). In the electrical and electronics parts categories, the ratios were 28.6% and 42.0%, respectively, showing that the competition is intensifying[13]. In the automotive category, a South Korean automotive company was ranked third[14] in the US automotive initial quality survey in fiscal years 2004 and 2006, showing quality improvement[15].

To compete effectively with up-and-coming companies from emerging countries, Japanese companies are seeking to differentiate their products by offering added value. More than half of the corporate and consumer product manufacturers are currently producing high added value products, and more companies aim to produce high added value products in the future[16]. By industry, in the "general machinery," "precision machinery," and "info-communication machinery and equipment/electronic parts and devices" industries, many companies responded that their future target products will be those in low and mid-range prices[17]. However, it is questionable if Japanese companies in these industries can compete with their Chinese, South Korean, and Taiwanese counterparts in commoditized products, which are their strength.

To offer added value, Japanese companies need to enhance research and development activities and further improve product quality control efforts. However, since the product quality of emerging countries' companies has been improving, Japanese companies should consider measures to promote the activities of other value chain functions such as sales and services, while maintaining their current

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[13] Ushida S. and Takahashi N. (2008), "Survey Report on Overseas Business Operation by Japanese Manufacturing Companies — Result of JBIC FY 2007 Survey: Outlook for Japanese Foreign Direct Investment (19th Annual Survey) —." Conducted on 600 companies in July and August 2007.

[14] J.D. Power and Associates, Press Releases (2004, 2006), "Initial Quality Study"

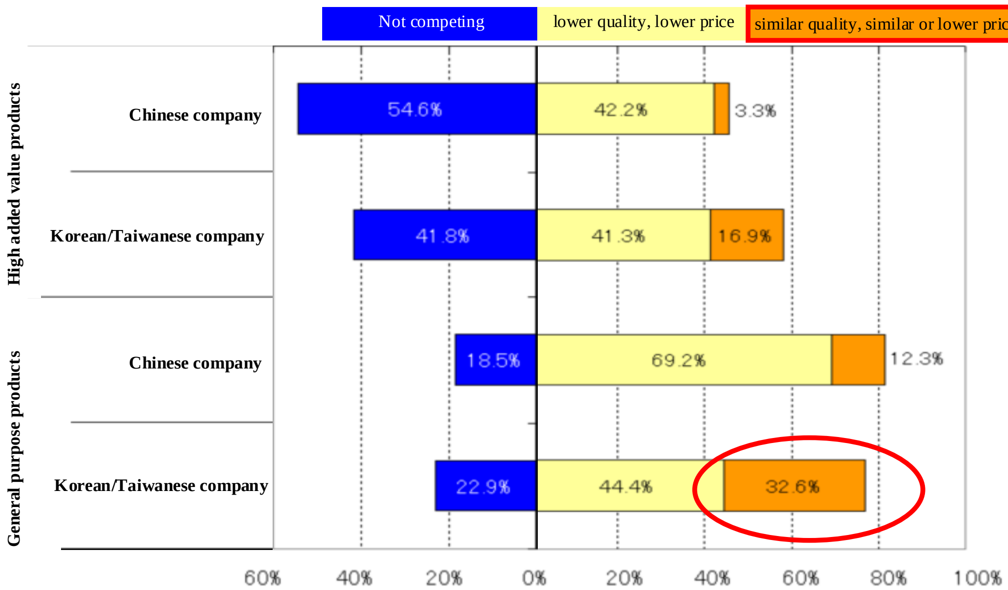
[15] However, JETRO (2007b), *KANKOKU, CHUUGOKU KIGYOU NO OUBEI SIJOU SENRYAKU* states that South Korean vehicles were classified as below average in the US vehicle dependability survey and were not necessarily highly evaluated.

[16] JETRO (2008), "Results of its Survey on International Operations of Japanese Firms 2007" (conducted in November 2007 and January 2008 and 733 companies responded).

[17] JETRO (2008), Same as above.

strength in manufacturing.

Figure 2-3-8 Competition with Chinese, South Korean, and Taiwanese companies in overseas markets (manufacturing

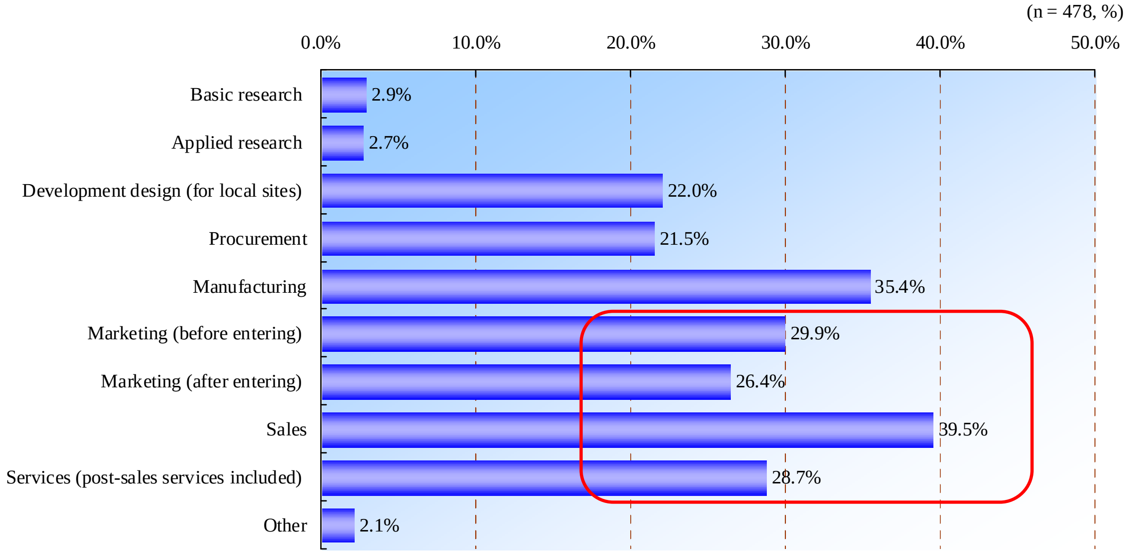


Note: Survey conducted on competition with Chinese and Korean/Taiwanese companies by product type (high added value/general purpose)
Source: Ushida, S. and N.Takahashi (2008), Report of the survey on overseas business development by Japanese manufacturing companies – fiscal 2007 (19th) survey results on direct foreign investment conducted on 600 companies in July and August 2007

(Strengthening "sales" function in the emerging countries' markets, which requires a commitment to meeting customer needs)

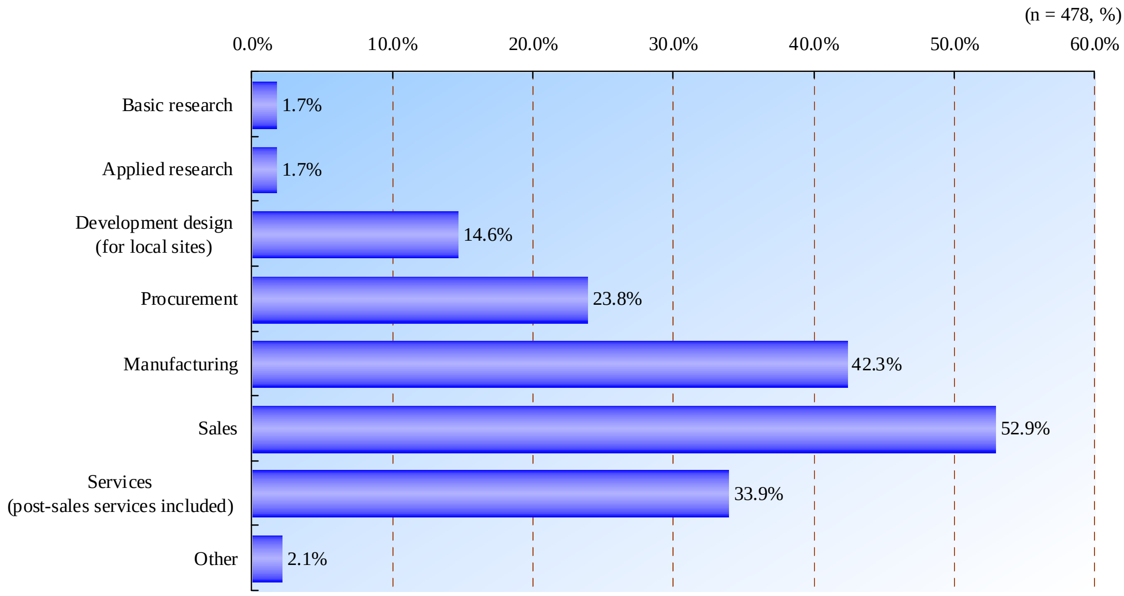
Among different value chain functions, Japanese companies need to strengthen the "sales" function the most to develop emerging countries' markets. In all, 39.5% of the companies responded that they needed to strengthen the "sales" function to capture emerging countries' markets, which was the highest ratio (see Figure 2-3-9). Moreover, in relation to the functions that are considered important at overseas bases, 52.9% of the responding Japanese companies, which is the highest for any one category (see Figure 2-3-10), stated that they believed that sales activities were crucial in the merging countries' markets.

Figure 2-3-9 Business function considered to need enhancement for capturing emerging countries' markets



Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies*

Figure 2-3-10 Functions that are considered important at overseas bases for capturing the emerging countries' markets



Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies*

To the next question, "What are the most important areas in your sales activities in the emerging countries' markets?" more than half of the companies responded that learning deeply about the needs of the local customers and providing accurate feedback to the R&D and services departments are key for expanding sales in the emerging countries' markets (see Table 2-3-11).

Figure 2-3-11 Important points in supplying products and services in emerging countries' markets in comparison with developed countries' markets

(n = 478)

Accurate feedback of customer needs to product and services departments	Promptly introducing into the markets products and services that meet the changing needs of customers	Curbing the prices for product and services quality	Enhancing product and services quality	Other
52.9%	31.2%	21.1%	11.3%	4.0%

Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies.*

In developing businesses in the merging countries' markets from product development to sales, companies need to closely and actively coordinate value chain functions to supply products and services meeting the customers' specific needs.

[Column 10] Aggressive global expansion of German small- and medium-sized companies (examples of Hidden Champions)

The German economy is supported by its strong exports. Its annual value of exports has been the highest in the world for several years. The leading medium-sized companies are the driving force behind the strong export[18].

Those leading medium-sized companies are represented in the group called "Hidden Champions[19]." This title came from the fact that they are the leading medium-sized companies that are ranked among the top three in the industry, but are less visible in general. There are 1,316 Hidden Champions groups in the German-speaking countries (Germany, Austria, and Switzerland). The average number of employees is a little over 2,000[20].

The Hidden Champions groups generated one million employment opportunities and increased their sales by 2.5 times between 1995 and 2005. The annual average growth rate was 9%, which is comparable with the GDP growth rates of emerging countries such as China and India.

Behind this phenomenal growth, there are some common driving factors shared across the Hidden Champions groups, one of which is outstanding technology development capability. In a sample comparison, the average number of patent applications per 1,000 employees in the Hidden Champions groups was about 31, while that of large companies was only 6. However, the average budget allocated to each patent was only one-fifth of that of large companies. The R&D efficiency is high in the Hidden Champions groups.

The other factor is their business model with a highly developed value chain and a customer-oriented approach. Instead of branching out into other business fields, these companies focused on developing their core businesses in order to increase their competitiveness. They have identified the areas in which their source of competitiveness lies, and they do not outsource functions in those areas. On the other hand, they actively outsource functions in other areas. In the area of procurement, they have been looking for high quality products and services from around the world. They are focusing on developing the core parts of their value chains.

This approach of focusing on developing the value chain is linked to the customer-oriented approach where direct customer contact is valued. Accordingly, most of the companies adopt a direct-sales system.

Another major factor behind the success of these local small- and medium-sized companies is top management with a global perspective. The average length of the tenure of the top management of

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18 In Section 2 of this Chapter, it was stated that in the Japanese small- and medium-sized companies, the production ripple effects from private consumption expenditure and public fixed capital formation are greater than those from exports and capital investment; further development of globalization is expected.

19 The name came from Simon, H. (1996), *Hidden Champions.*

20 Source: JETRO Deutschland website

companies in the Hidden Champions groups is very long (about 20 years). The strong leadership of these management individuals, who had clear visions to establish strong value chains, contributed to the successes. By geographic region, sales in Asia and Eastern Europe have increased substantially. With the top management having global visions, companies in the Hidden Champions groups are transforming themselves from the trans-Atlantic type companies whose main sales come mainly from Western Europe and the United States to the Eurasia type companies, who aim to expand sales in Central and Eastern Europe as well as Asia.

Companies in the Hidden Champions groups mostly hire employees from the local communities. From the perspective of human resources, these companies are rooted in the communities where they operate, and are not expanded globally. However, in the areas where they are strong, these companies have boldly set out to capture international markets, which is considered to be the key to their success.

(3) Issues involved in Japanese companies' business development into the emerging countries' markets

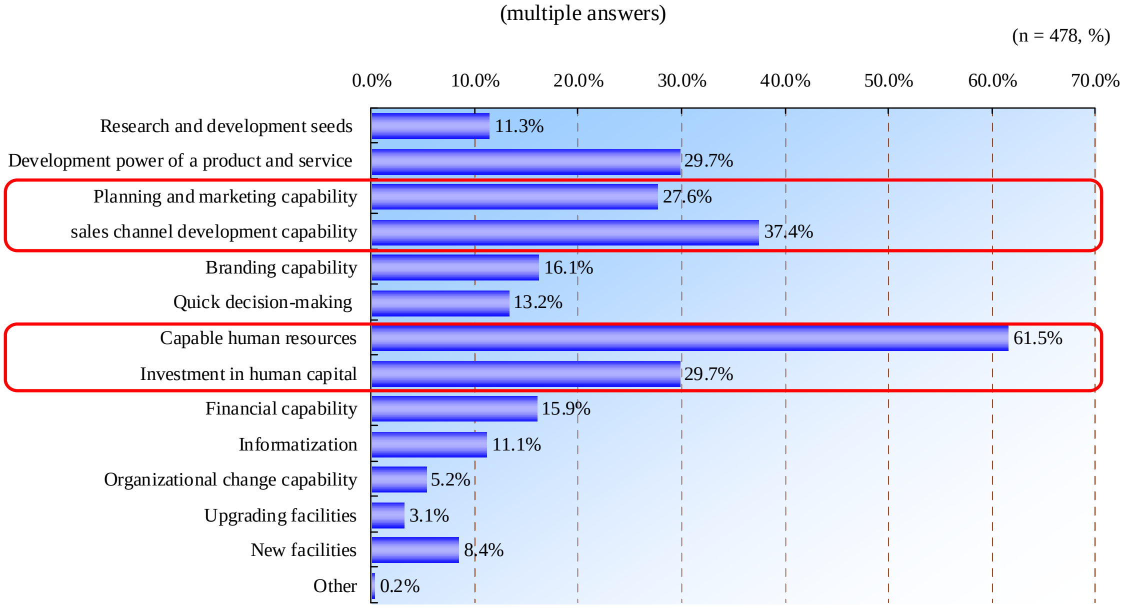
In the section above, we discussed the issues in Japanese companies' business development by value chain function. In this section, we will consider how Japanese companies should strengthen their competitiveness as they develop businesses in emerging countries' markets.

(Importance of accumulating intangible assets)

To the question, "Which management resource areas will become the most important in the increasingly competitive environment?" 61.5% of the responding Japanese companies, which is far higher than any other category, indicated "capable human resources," 37.4% indicated "sales channel development capability," and 29.7% indicated "product and services development capabilities" and "investment in human capital" (see Figure 2-3-12). Few companies indicated "upgrading facilities" and "new facilities" (less than 10% for both), which are tangible asset investments. From the above, we see that Japanese companies place more importance on intangible management resources such as "human resources," "sales channels," and "development capability" than tangible assets like facilities.

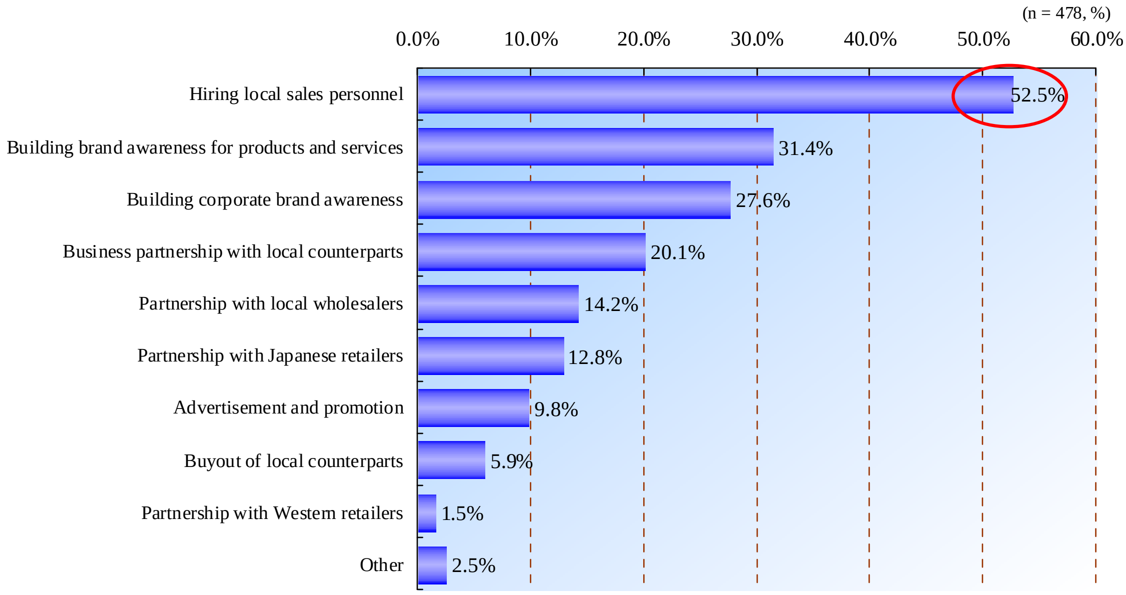
In relation to the methods for enhancing the "sales" function, which Japanese companies regard as the most important in developing businesses in the emerging countries' markets, respondents indicated "hiring local sales personnel" as the most important (52.5%) followed by "building brand awareness for products and services" and "business partnership with local counterparts." From this, we see that Japanese companies place greater emphasis on "human resources" (see Figure 2-3-13).

Figure 2-3-12 Management resources needed to be reinforced to survive in the global market (multiple answers)



Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies.*

Figure 2-3-13 Functions needed for enhancing the sales force (multiple answers)



Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies*.

(Deficient intangible assets in Japanese companies)

Various efforts have been made to measure "intangible assets" such as "human resources," "sales function," and "branding capability."[21] Fukao et al (2007) pointed out that Japan has not sufficiently

[21] Various initiatives made to measure intangible assets listed below.
EUROSTAT; FASB (Financial Accounting Standards Board); van Ark, B. (2004), "The Measurement of Productivity: What Do the Numbers Mean?"; Corrado, C., C. Hulten,, and D. Sichel (2006), "Measuring Capital and Technology: An Extended Framework"; Fukao K., S. Hamagata, T. Miyagawa, and K. Tonogi

developed and accumulated "economic competitive capabilities" (see Figure 2-3-14). Japanese companies are not lagging too much behind the United Kingdom and United States in the areas of "computerized information" and "innovative property," which represent the accumulation of IT capital and research and development capabilities and other resources. However, the accumulation of intangible assets such as "brand property," "corporate-specific human capital," and "cost of organizational changes," which represent "economic competitive capabilities," has not progressed sufficiently. These facts possibly serve as a hindrance to the increasing productivity of Japanese companies.

Figure 2-3-14 Quantitative comparison of intangible assets in Japan, the U.S., and the U.K.

	Japan		U.S.	U.K.
	1980–1989	1990–2002	1998–2000	2004
Computerized property	0.8	1.7	1.7	1.7
Build-to-order software	0.4	0.9		
Software package	0.0	0.1		0.6
Internally developed software	0.3	0.5	1.6	1.1
Database	0.1	0.2	0.0	
Innovative property	2.9	3.5	4.6	3.2
Science and engineering R&D	1.4	1.9	2.0	1.1
Resource royalties	0.0	0.0	0.2	0.0
Copyright and license	0.8	0.9	0.8	0.2
Other product development and design, non-scientific R&D	0.7	0.7	1.6	1.9
Economic competitive capabilities (Lower than the U.S. and U.K.)	2.2	2.4	5.4	5.0
Brand property	0.7	0.9	1.5	1.0
Corporate-specific human capital	0.4	0.3		2.4
Cost of organizational changes	1.2	1.2	3.9	1.6
Total	5.9	7.6	11.7	10.0

Sources: Japan－Fukao et al. (2007); U.S.－Corrado, Hulten, and Sichel (2006); U.K.－Marrano and Haskel (2006)

According to the survey of JETRO in 2007 (2007c), about 62% of the responding companies stated that they were confident about their technological capabilities, but not in building business models. There might be delays in implementing organization restructuring initiatives for realizing maximum synergy by organically linking various management resources.

Therefore, the important issues for Japanese companies in increasing productivity and enhancing competitiveness in the emerging countries' markets are securing human resources, enhancing sales capabilities, and organizational restructuring.

(Initiatives related to "human resources," the management resource perceived as being most deficient)

As mentioned above[22], among all management resources, Japanese companies, in their efforts to survive in the competitive global market, perceived the deficiency of "capable human resources" most strongly[23].

(2007), "Intangible Investment in Japan: Measurement and Contribution to Economic Growth."

22 See Figure 2-3-12.

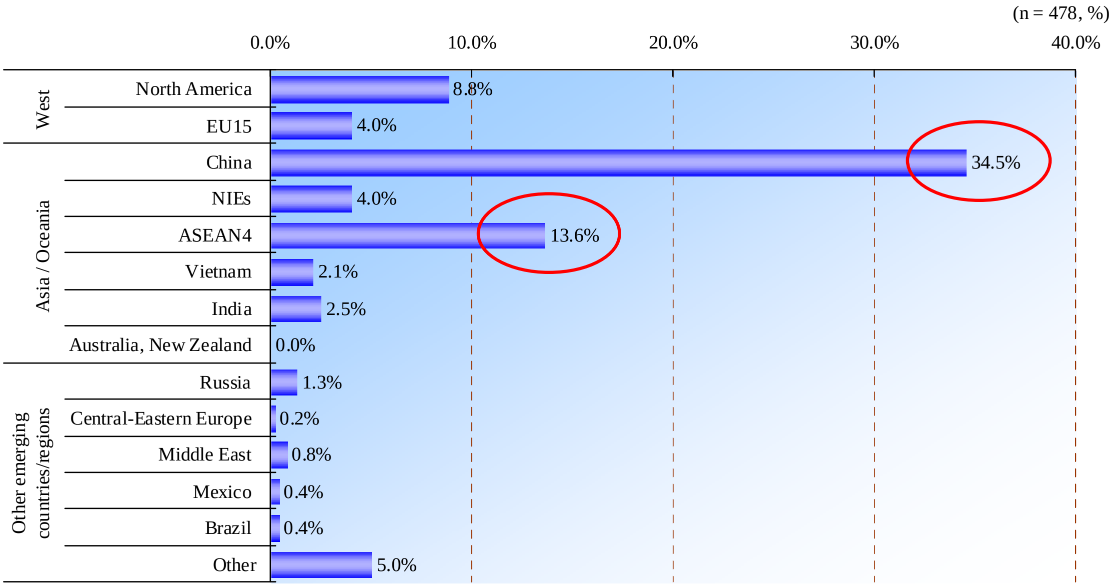
23 Section 1 of this Chapter describes the status of the intensifying worldwide competition for acquiring human resources

○ **Countries, regions, job class, and job type in which human resource supply is insufficient**

First, we will examine the areas that are deficient in human resources and also determine the types of human resources that are deficient in supply.

In securing human resources, Japanese companies perceive the greatest difficulties in China and ASEAN4 (see Figure 2-3-15). Furthermore, they perceive deficiency most strongly in the following areas: job class, "middle manager (department/section chief)" and "foreman and supervisor" and job type, "marketing and sales staff" (see Figure 2-3-16). Moreover, more than 80% of the responding companies consider that there will be greater needs for personnel who can serve as a liaison between the domestic and overseas business bases[24].

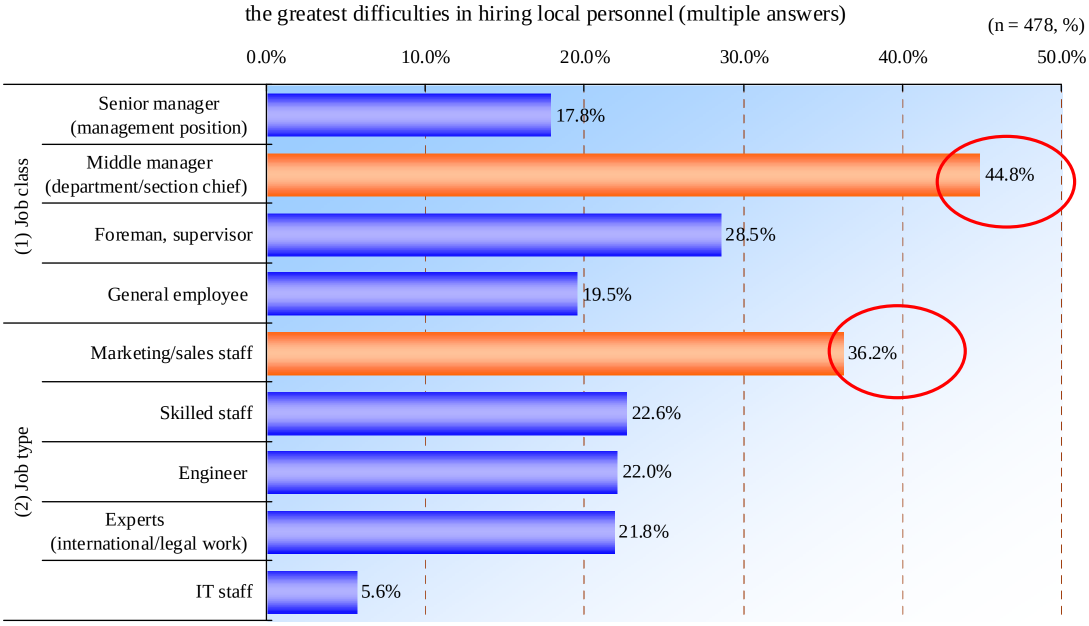
Figure 2-3-15 Countries and regions where Japanese companies perceive the greatest difficulties in hiring local personnel



Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies*

[24] The Japan Economic Foundation (2008), *GLOBALIZATION GA SEKAI OYOBI NIHON KEIZAI NI ATAERU EIKYOU NI KANSURU CHOUSA KENKYU.*

Figure 2-3-16 Job class and job type in which Japanese companies perceive the greatest difficulties in hiring local personnel (multiple answers)



Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies*

In China and ASEAN4, where many Japanese companies, as well as companies from other countries operate, the labor supply is tight. In China, in particular, the labor market is expected to remain tight for some time due to the fact that middle-aged managers, who had already entered the working age in the Cultural Revolution period, did not receive the education or training needed in management roles[25].

On the other hand, among Japanese companies that do not operate overseas, there are some companies who stated they could not hire enough labor from the Japanese labor market: specifically, 8.8% of the responding companies for the middle managers and 14.4% for the specialist workers (see Table 2-3-17). The problem of securing human resources is no longer restricted to companies with overseas business bases[26].

Figure 2-3-17 Can your company hire enough labor only from the Japanese labor market?

(%)

			Yes, fully or almost fully	No, not really or not at all
Middle managers		Total (n = 389)	70.4	29.6
	Overseas operation (n = 385)	Yes	36.3	63.7
		No	91.2	8.8
	Overseas sales ratio (n = 376)	30% or over	35.7	64.3
		0% - less than 30%	55.5	44.5
		0%	91.8	8.2
Specialist workers		Total (n = 384)	64.6	35.4
	Overseas operation (n = 380)	Yes	29.9	70.1
		No	85.6	14.4
	Overseas sales ratio (n = 372)	30% or over	31.9	68.1
		0% - less than 30%	45.4	54.6
		0%	88.2	11.8

Source: *Report by Global Human Resources Management Study Group* (METI)
(The survey was conducted in January 2007. The number of valid responses was 406.)

25 Manpower Japan Co., Ltd. (2006), *Manpower's White Paper "The China Talent Paradox"*
26 The discussion on the domestic regulations on hiring foreign labor is presented in Chapter 2-4.

○ **Measures for securing human resources**

Next, we will examine the measures on which Japanese companies place importance in securing human resources in tight labor markets.

As measures to secure capable human resources, 51.5% of the responding Japanese companies, the highest for any one category, indicated "providing incentives through promotion and selection opportunities," 42.1% indicated "enhancing education and training opportunities," 38.3% indicated "raising wages," and 26.4% indicated "implementing and enhancing performance-based compensation systems" (see Table 2-3-18). From this, we see that Japanese companies are adopting a variety of approaches to secure human resources, other than simply raising wages, which would have a direct impact[27].

Figure 2-3-18 Measures considered necessary for acquisition of local and capable human resources

(n = 478)

Providing incentives through promotion and selection opportunities	Enhancing education and training opportunities	Raising wages	Implementing and enhancing performance-based compensation systems	Enhancing recruiting activities	Establishing and popularizing product and corporate brands	Spreading Japanese employment practice	Other
51.5%	42.1%	38.3%	26.4%	21.3%	17.8%	13.8%	1.5%

Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies.*

○ **Role and authority granted by Japanese companies to local staff**

A survey was undertaken on initiatives related to the operations and business model undertaken by Japanese companies expanding their business overseas. The results of this survey[28] were helpful in learning about Japanese companies' initiatives related to the delegation of authority to overseas offices and subsidiaries. According to the survey results, 53.6% of the responding companies indicated "preparing standardized operations that can be handled by local staff" and 43.0% indicated "creating uniform quality control standards applicable to overseas operations" as important initiatives (see Table 2-3-19). From this, it can be stated that Japanese companies place importance on promoting the use of local workers in overseas operations.

Figure 2-3-19 Initiatives for standardization and systematization of operations and business models

(n = 302)

Preparing standardized operations that can be handled by local staff	Creating uniform quality control standards applicable to overseas operations	Building IT systems that can be applied throughout domestic and overseas operations	Standardizing human resources management	Building business models that can be applied globally	Other
53.6%	43.0%	26.5%	26.5%	21.9%	2.3%

Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies.*

27 Descriptions on wages of managers are provided in Chapter 2-2.

28 The Japan Economic Foundation (2008), *GLOBALIZATION GA SEKAI OYOBI NIHON KEIZAI NI ATAERU EIKYOU NI KANSURU CHOUSA KENKYU.*

○ Delegation of organizational authority—an area in which Japanese companies are weak

The substantial increase in the number of overseas bases would require changes in the authority delegation systems in organizations. As mentioned above[29], promotion and selection opportunities are offered to capable personnel; in addition, there is a shortage of middle managers. Taking these facts into account, it is important to consider how Japanese companies should delegate authority to their overseas offices and subsidiaries. The survey results conducted by the Japan Economic Foundation (2008) will provide information on Japanese companies' approaches to delegating authority.

First, to the question enquiring about their stance toward authority delegation, 54.4% of the responding Japanese companies stated that they aimed to further promote authority delegation in the future. About 70% provided the following as reasons: "proper judgments can be made when local information is available" and "quick decisions can be made" (see Table 2-3-20).

Figure 2-3-20 Reasons for promoting authority delegation to overseas offices and subsidiaries

(n = 260)

Proper judgments can be made when local information is available	Quick decisions can be made	Flexible decisions can be made	Local staff can make better and appropriate decisions	Other
73.5%	68.5%	22.7%	20.4%	1.5%

Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economi*

These indicated reasons are consistent with the facts that flexible and quick decision-making and acquiring local site-specific business information are becoming increasingly important[30], and information gathering and quick response are keys to operating successfully in emerging countries' markets. This is also related to the deficiency of local sales personnel perceived by overseas operators.

However, examining the conditions of authority delegation in detail, while the practical areas such as "changing vendors and/or buyers of products and services," "personnel change within overseas subsidiaries (and group companies)," "hiring and terminating employees" made progress, strategic areas such as "additional investment in ongoing projects," "executing strategic partnerships and/or M&As," and "starting new businesses" have not moved forward. The main business control functions are still exercised by the headquarters in Japan (see Figure 2-3-21).

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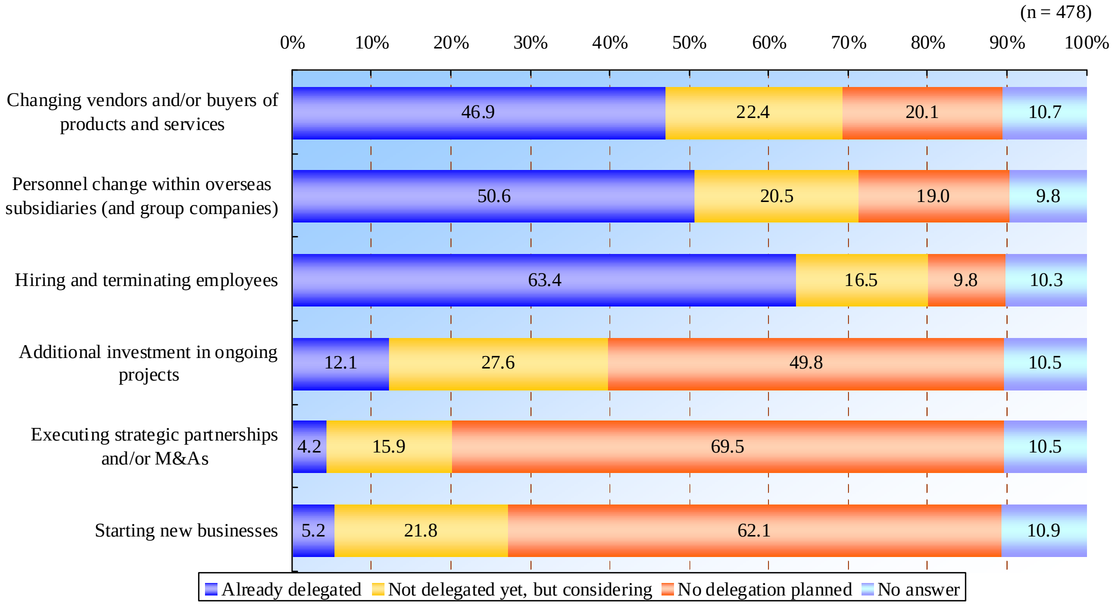
[29] See Figure 2-3-18.

[30] Source: The Japan Economic Foundation (2008), *GLOBALIZATION GA SEKAI OYOBI NIHON KEIZAI NI ATAERU EIKYOU NI KANUSRU CHOUSA KENKYU*

Figure 2-3-21 Areas of authority delegation



Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies.*

Moreover, to the question regarding the personnel necessary for successful authority delegation to overseas offices and subsidiaries, many of the responding companies stated that capable personnel who can ensure smooth communication between domestic and overseas bases would be required, and that Japanese staff rather than local staff are considered to be more suitable for the role (see Table 2-3-22). Only 20% of the responding companies consider that local staffs, who have full knowledge about their local conditions and access to local-specific information, can make proper judgments and decisions[31]. In light of this, we could state that Japanese companies rely excessively on communication among Japanese staff in their international operations, and there is a concern about their abilities to properly gather local information.

Figure 2-3-22 Methods considered appropriate for acquisition of personnel who perform international services (multiple answers)

(n = 403)

Developing and promoting Japanese employees	Developing and promoting locally-hired employees	Hiring and developing international students	Hiring foreign mid-career professionals	Other
77.2%	59.3%	11.9%	13.6%	3.2%

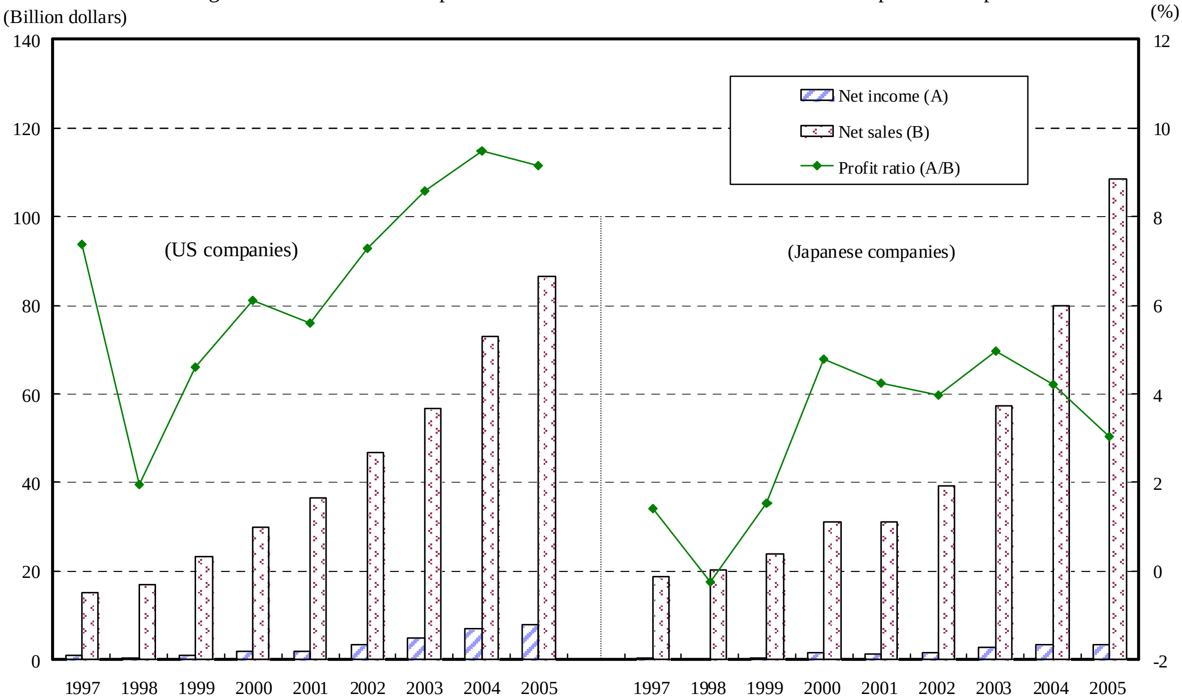
Source: The Japan Economic Foundation (2008), *Survey on overseas business strategies of Japanese companies.*

(US companies' initiatives for increasing sales capabilities and securing human resources, as seen in their business development in China)

There are major differences in business strategies for the China market between Japanese and US companies. The profit ratios of the Chinese subsidiaries of US companies are higher than those of Japanese companies (see Figure 2-3-23). In the following paragraphs, we will discuss the factors behind the greater success of US companies compared to their Japanese counterparts in the China market.

[31] See Table 2-3-20.

Figure 2-3-23 Transition in profit ratios of Chinese subsidiaries of US and Japanese companies



Notes: 1. Net income is income after tax. Profit ratio was calculated as net income divided by net sales.
2. Figures for US subsidiaries are those announced by US Department of Commerce.
3. Figures for Japanese subsidiaries were compiled from those (net sales and net income) submitted by responded companies that are in operation. Net losses were recorded as negative numbers.

Sources: Ozeki, H. (Forthcoming); Website of the Bureau of Economic Analysis, US Department of Commerce; METI, *Basic Survey on Overseas Business Activities* .

○ US companies emphasized sales in the local markets

While Japanese companies established Chinese manufacturing bases looking for cheaper labor in China, US companies, from the beginning, placed greater emphasis on selling products locally than on manufacturing[32].

In the survey asking European and US companies[33] about their purposes of Chinese businesses, 51% of US companies indicated "local sales of products and services[34]."

Moreover, according to the survey targeted at European and U.S., and Japanese companies inquiring when they started sales of their main products in China (see Figure 2-3-24), more than half of the responding European and US companies stated that they started between 1991 and 1995, which is earlier than Japanese companies did.

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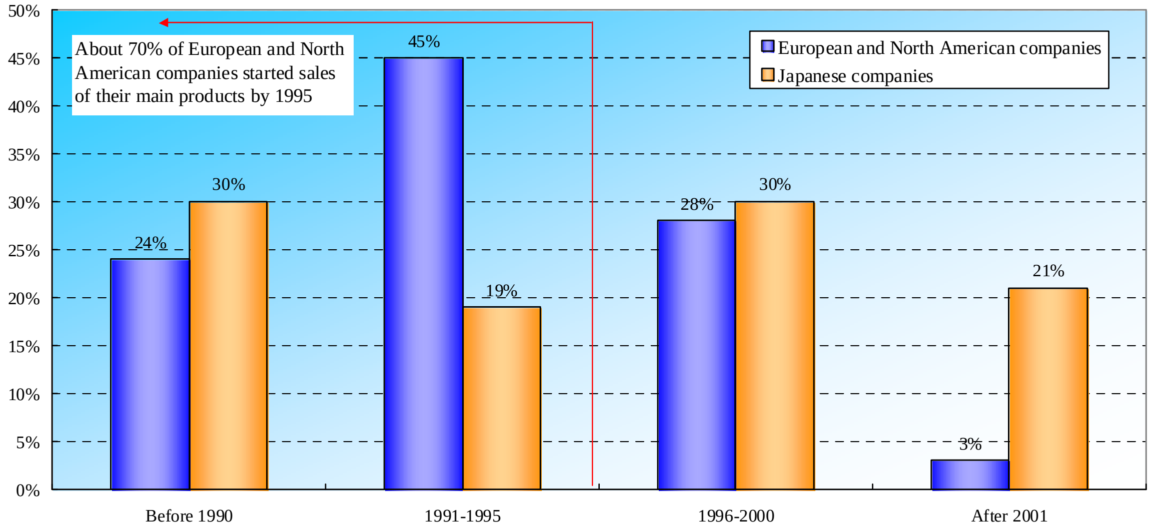
32 There are several explanations pointed out by some experts about why US companies placed emphasis on local sales in China from the beginning. For example, JETRO (2006), "BEIKOKU KIGYOU NO TAI CHUUGOKU KEIEI SENRYAKU" points out the following: (1) under NAFTA, the international division of labor had been undertaken, and the U.S. had already established its manufacturing bases in neighboring Canada and Mexico; (2) US companies had withdrawn from manufacturing low added value electrical and electronic products, in which China has competitive strength; (3) most US companies, such as fabless semiconductor companies, had already outsourced their manufacturing functions, and as a result, they established only sales bases in overseas markets.

33 Although the survey was not conducted on US companies but on European and US companies, the material was used since it helps understand the characteristics of Japanese companies.

34 The American Chamber of Commerce People's Republic of China (2008), "2008 White Paper on American Business in China"

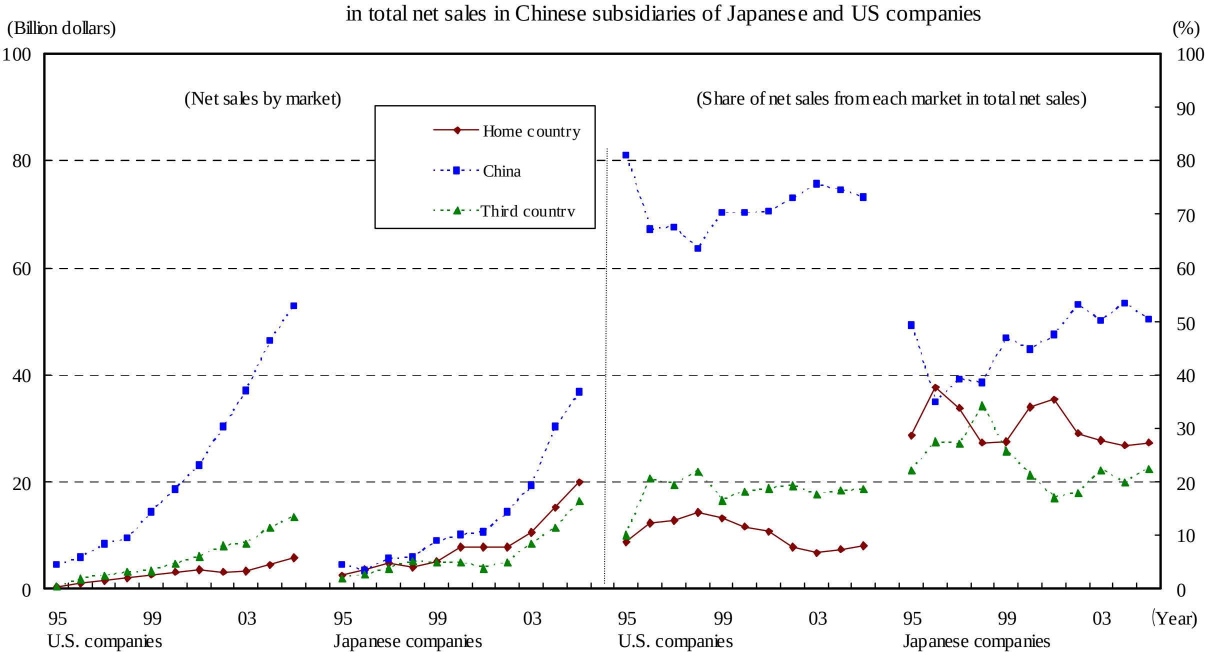
Figure 2-3-24 Starting time of sales of main products in the China market by Japanese and European/North American companies



Source: ABeam Consulting (2005), *Survey on sales and marketing activities of foreign consumer goods manufacturers in*

In order to see the results of the sales activities of Chinese subsidiaries of Japanese and US companies, we compared their net sales by market and the share of net sales from each market in the total net sales. US companies' Chinese subsidiaries showed grater values in net sales in China and share of sales from China in total sales (see Figure 2-3-25).

Figure 2-3-25 Comparisons of net sales by market and share of net sales from each market in total net sales in Chinese subsidiaries of Japanese and US companies



Notes: 1. Figures are those of foreign subsidiaries in which the parent company owns more than half of the shares.

2. Figures for U.S. companies are based on estimation by U.S. department of Commerce. Figures for Japanese companies are based on estimation as described below. With a part of data collected from some respondents, there were inconsistencies in numbers between a total net sales and summation of net sales from each market. Because of this, only data without inconsistencies collected from companies that are in operation was used. Net sales for each market were calculated as total net sales multiplied by share of net sales from each market (which were estimated based on data without inconsistencies only).

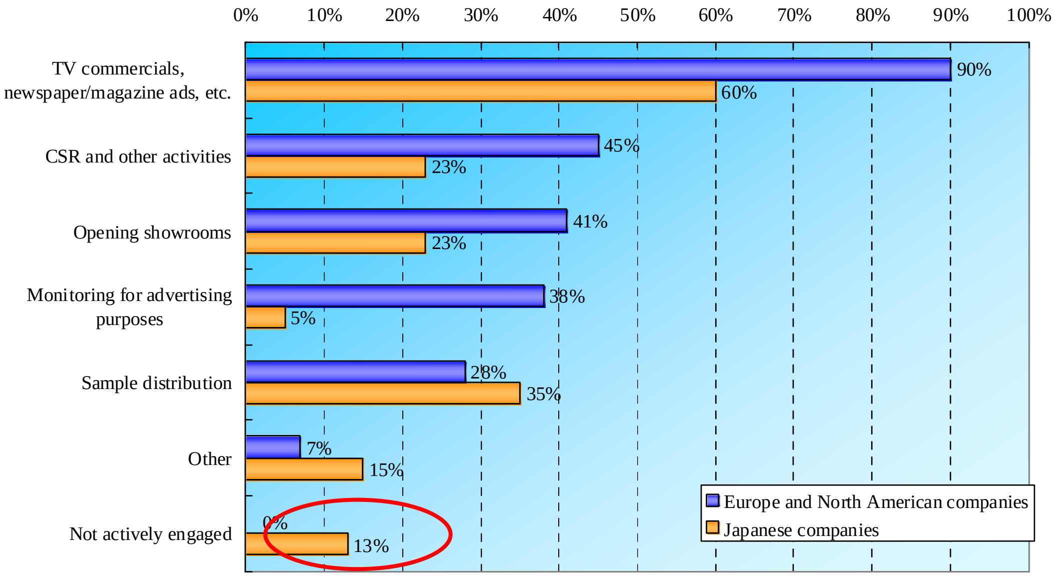
3. 2005 figures for US companies are based on preliminary estimates.

Sources: Ozeki, H. (2008); Website of the Bureau of Economic Analysis, U.S. Department of Commerce; *Basic Survey on Overseas Business Activities* (METI)

Although this was caused by some geographical and economical factors that did not exist in Japan, the fact that US companies started to focus on strengthening sales capabilities in China ahead of Japanese companies contributed to increasing their corporate values, as the potential for growth in the China market is even greater than that perceived before. These differences in business development strategies between Japanese and US companies are considered to be among those factors that have created differences in local sales capabilities in the China market.

Another factor that has contributed to increasing US companies' sales capabilities is their sophisticated approaches in PR activities. To the question enquiring about the brand-building efforts in the China market, 13% of the responding Japanese companies stated that they were not actively engaged in it, while none of the European and US companies conceded this (see Figure 2-3-26). Even in other areas, European and US companies are ahead of Japanese companies. Japanese companies should enhance their sales capabilities in China by strengthening their competitive capacity in PR activities.

Figure 2-3-26 Brand-building efforts in Chinese market (multiple answers)



Source: ABeam Consulting (2005), *Survey on sales and marketing activities of foreign consumer goods manufacturers in China*.

○ US companies' creative efforts in securing human resources[35]

According to a survey conducted by ChinaHR.com Corporation that operates a human resources related website, the popularity ranking of US companies among job-seeking university students is higher than that of Japanese companies.

The US companies' PR activities include setting up R&D bases in China, showing their long-term commitment to the China market, and providing scholarship for academically excellent university students.

Moreover, the labor turnover rates in US companies operating in China are lower than those of Japanese companies. According to a research conducted by Shanghai FESCO, the largest temporary staffing company in China, the turnover rates of the Chinese staff at Japanese companies are more than

35 Referred to JETRO (2006), "BEIKOKU KIGYOU NO TAI CHUUGOKU KEIEI SENRYAKU".

twice as high as those at European and US companies (as of the end of 2005). The average turnover rate (ratio of employees who left during the past one year to the total number of employees) of foreign subsidiaries is 14%. That of Japanese subsidiaries is 15.1%, while that of European and US subsidiaries is 6.3%[36].

In addition, as already discussed above, the authority delegation to local staff, as well as the promotion of local staff, is limited at most Japanese companies. These factors also contribute to the low popularity of Japanese companies.

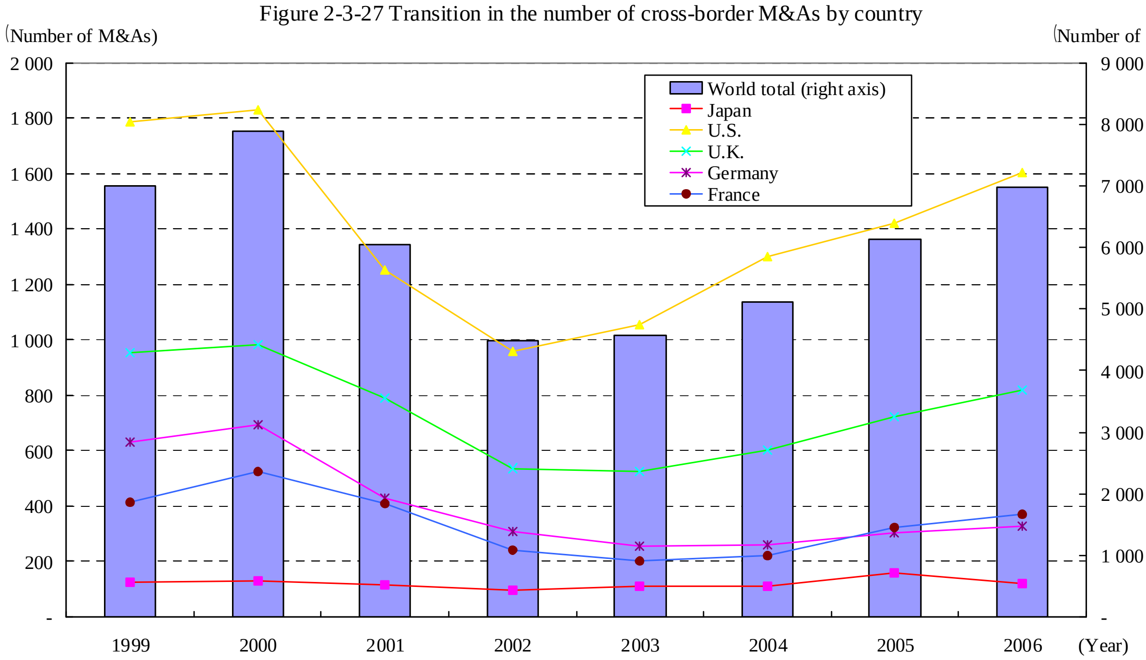
The abovementioned examples of initiatives implemented in the China market by the US companies provide some implications for securing human resources and improving sales capabilities, which are issues that Japanese companies need to address.

(Considerations of M&A and business partnership, which enable responses to the changing market environment and rapid business development)

In order to develop value chains in the competitive environment where thorough knowledge and understanding of local markets and prompt responses to opportunities and changes are required, cross-border M&A, which utilizes existing management resources, is becoming a suitable and valuable solution to meet both requirements.

Looking at changes in the number of M&As worldwide, we see that it was very low in 2001 and 2002, as a result of the IT bubble burst primarily in the United States. However, since that time, is has been increasing (see Figure 2-3-27). Contrary to the worldwide growing trend, the number of M&As of foreign companies by Japanese companies is not growing considerably.

Figure 2-3-27 Transition in the number of cross-border M&As by country



Source: UNCTAD, *WIR Annex Tables*.

[36] As already discussed above, the authority delegation to local staff, as well as the promotion of local staff, is limited at most of Japanese companies. These factors are also contributing to the low popularity of Japanese companies.

However, Japanese companies have started to recognize the importance of M&As in recent years. About 60% of Japanese companies consider M&As and strategic partnerships as being vital in their overseas operations[37]. They considered the following as the major reasons for this: "business development into emerging country markets" 59.2%; "strengthening existing business domains" 58.6%; and "speedy acquisition of management resources" 44.4% (see Table 2-3-28). The percentage for the "strengthening existing business domains" was the highest, showing that many companies consider M&As and strategic partnerships as highly effective tools for entering emerging countries' markets.

To the question about what functions they aim to strengthen by M&As and/or strategic partnerships, 63.8% of the responding Japanese companies, the highest for any one category, indicated "sales function;" 41.1% "manufacturing function;" and 32.2% "marketing function." The sales and marketing capabilities are considered important in expanding business into emerging countries (Table 2-3-28). In fact, the largest percentage of responding companies indicated "sales network[38]" as the management resource they expected to acquire from M&A target companies (see Table 2-3-28). In line with the fact that the acquisition of the sales function is seen as a highly important factor, in recent years, Japanese companies have tended to determine their strategic development directions based more on the consumption growth potential in respective markets, rather than on manufacturing and other cost factors.

The two main characteristics of recent Japanese companies' M&A activities are (1) aiming to grow in size and (2) focusing on core businesses[39]. They are taking bold steps to bolster their international competitiveness in their core businesses.

What would it take to further promote this ambitious trend? To the question what are the hindrances to M&As and strategic partnerships, many responding companies indicated "insufficient local information" and "undeveloped legal and accounting systems" other than regulations on business establishment and development. Finding service providers who can help resolve these issues will be one of the key factors (see Table 2-3-28).

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[37] The Japan Economic Foundation (2008), *GLOBALIZATION GA SEKAI OYOBI NIHON KEIZAI NI ATAERU EIKYOU NI KANSURU CHOUSA KENKYUU.*

[38] In Chapter 2-4, in relations to the Japanese logistics network, which is closely linked to the sales network, we will discuss its loss of relative importance as a regional logistics and transhipment hub.

[39] Japan Institute for Overseas Investment (2007), "NIHON KIGYOU NO TAIGAI CHOKUSETSU TOUSHI DOUKOU"

Figure 2-3-28 Corporate strategies and issues regarding M&A, strategic partnerships, and business development

Purpose of M&A (multiple answers, n = 304)	
Business development into emerging country markets	59.2%
Strengthening existing business domains	58.6%
Speedy acquisition of management resources	44.4%
Business development into developed country markets	28.3%
Business diversification	17.1%
Other	1.0%

Functions to be strengthened by M&A (multiple answers, n = 304)	
Sales	63.8%
Manufacturing	41.1%
Marketing	32.2%
R&D	19.7%
Procurement	15.5%
Post-sales services	8.2%

Valued resources in M&A target firms (multiple answers, n = 304)	
Sales network	57.2%
Technologies and expertise	49.7%
Human resources and branding capabilities	46.4%
Tangible assets, such as facilities	20.4%
Other	3.3%

Hindrances to M&A and other business development (multiple answers, n = 478)	
Unavailability of local information	41.8%
Undeveloped legal and accounting systems	40.2%
Regulations on business establishment	29.9%
Regulations on local business development	26.2%
Difficulties in using M&A intermediaries	12.3%
Regulations on transferring/hiring employees	11.3%
Difficulties in taking advantage of local preferred treatment	6.9%
Other	6.9%

Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies.*

(Initiatives to achieve a global standard to promote competitive advantages arising from technological development capabilities)[40]

The advantages in technological development capabilities do not necessarily guarantee competitive advantages in the product markets. A company's competitive advantage in markets is also determined by other factors such as sales, marketing capabilities, and business model building capability. In addition, in recent years, differences in the achievement of global standards occasionally determine competitive advantages in markets. In this section, we will discuss Japanese companies' initiatives to achieve global standards.

Over half of the responding companies recognize the increasing importance of achieving global standards for their products and services[41]. 55.8% of the responding companies, which is the highest percentage, indicated "increasing market power by establishing a global standard for their favored technology" as a major reason for their attempt to achieve global standards for their products and services (see Table 2-3-29).

Figure 2-3-29 Reasons for aiming to achieve global standards (multiple answers)

(n = 260)

Increasing market power	WTO TBT Agreement came into force	Preventing unfavorable ones from becoming global standards	Other
55.8%	31.2%	28.8%	3.5%

Source: The Japan Economic Foundation (2008), *Research survey of the impacts of globalization on the global and Japanese economies.*

By establishing a global standard, a company can not only increase its market power but also avoid any disadvantages that would occur when another company establishes a global standard. In addition, the company can earn substantial revenue by obtaining patent rights for the global standard and licensing them to other companies. In the following section, two related cases will be introduced.

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[40] Achieving a "global standard" mentioned here does not indicate acquiring an existing international standard certification, but making a company's own technology a global standard.

[41] The Japan Economic Foundation (2008), *GLOBALIZATION GA SEKAI OYOBI NIHON KEIZAI NI ATAERU EIKYOU NI KANSURU CHOUSA KENKYUU*

Case 1 MEMS[42] global standardization activity—built-in intellectual property

This example is a case where a Japanese industry association undertook initiatives to protect the companies in the industry from suffering disadvantages, which could have resulted from a foreign company's strategic initiatives. The foreign company is a competitor to Japanese companies and attempted to lead in the global standard setting[43].

In the field of MEMS, Japan has technological advantages. Due to the constant efforts made by Japan's Micromachine Center (MMC), who recognized the importance of global standardization at the early stage, and to a professional in the industry who had personal connections with key people with significant influence over global standardization activities in each country, the proposals led by Japan have been adopted as global standards in the areas of terminologies and evaluation and testing methods.

However, in 2006, Republic of Korea started to submit proposals for MEMS global standardization, the area where Japan has played a leadership role, in the areas of process evaluation and device performance evaluation (see Table 2-3-30). Japan displayed leadership in the areas of terminologies and evaluation methods. Although these areas were important in building common ground in the early stage of standardization, they are the "non-competing areas," which do not have direct impacts on products' performance. On the other hand, the areas of process evaluation and device performance evaluation, where Republic of Korea submitted its proposals, are near "competing areas" would have impacts on the evaluations of performance and characteristics of each manufacturer's products. Being greatly alarmed by this, MCC developed the "MEMS Standardization Roadmap" for promoting strategic standardization initiatives.

Figure 2-3-30 MEMS standardization proposals by field from Japan and Republic of Korea

Area	Standardized	Under deliberation	To be proposed
Terminology	MEMS glossary		
Common specification		MEMS common specification	
Material evaluation method	Thin film tensile testing method	Thin film fatigue testing method	Accelerated material life testing method
Process evaluation	Thin film standard test piece for tensile testing	Material bending test method	
		Joint strength test method	
Device performance evaluation		RF MEMS switch	
		FBAR filter	
		Proposal from Japan	Proposal from South Korea

Notes: Yellow highlights indicate proposals from Japan. Pink highlights indicate proposals from Republic of Korea.
Source: NEDO (2006), *Basic survey on research and development and standardization conducted by the New Energy and Industrial Technology Development Organization (NEDO).*
Revised materials provided by Kuniki Owada, International Standardization Engineering Laboratory.

In Republic of Korea, the national government is assuming a strong leadership role. For example, global standardization activities are supported as part of national strategies[44] and a government officer

[42] MEMS (Micro Electro Mechanical System) is a device in which electronic circuits (control unit) and micro mechanical structures (drive unit) are integrated on one substrate. MEMS is manufactured using varieties of micro processing technologies such as semiconductor manufacturing technology and laser processing technology (METI (2007b) *Technology Strategy Map 2007*).

[43] Referred to NEDO (2006), *NEDO GIJUTSU KAIHATSU KIKOU NI OKERU KENKYUU KAIHATSU TO HYOUJUNKA NI KANSURU KISO CHOUSA*

[44] The South Korean Constitution recognizes the national standards as a core requirement for industrial and

serving in the Industrial Planning Department developed a strategic scenario for standardization. In Japan, global standardization activities have developed by taking advantage of the measures undertaken by the national government, while solidifying the foundation built in the areas of terminology, testing and evaluation, and testing methods. Based on the “MEMS Standardization Roadmap,” continuous efforts are being made to create and submit global standardization proposals for product and device specifications.

In a competitive environment where different countries strive to achieve global standards, MCC responded quickly to protect Japanese companies from suffering disadvantages, which could have incurred if a foreign company had gone ahead. MCC has successfully safeguarded the MEMS field where substantial future growth potential lies and where Japanese companies have technological advantages.

Although Japan and Republic of Korea have been in a competitive relationship in the MEMS filed global standardization, it is important that the parties involved maintain a balance between “competition and cooperation.” In the survey, 68.6% responding companies stated that partnerships among countries are necessary in carrying out global standardization activities[45], and indicated both European and US developed countries (54.2%) and Asian emerging countries (48.0%) as important partner countries[46]. They do not merely consider developed countries but rather the whole world in pursuing global standardization activities.

Case 2 Built-in intellectual property

By incorporating intellectual property such as patent rights into global standards, companies can spread their technologies, establish competitive advantage, and secure a revenue base. A successful example of global standards incorporating intellectual property can be seen the field of DVD, where a new market was created and the technology gained popularity.

In relation to DVD standardization, the DVD forum-standard was established based on the technologies developed primarily by the Japanese companies. Later, ECMA[47] developed a revised DVD standard, which was adopted by the ISO/IEC JTC[48] as a global standard. The DVD technology patents are held in a “patent pool” and participating companies can receive patent royalties in proportion to the sales amount of products incorporating the licensed technology.

Moreover, the DVD media global standards incorporate the original technologies of Japanese

national development, and states that establishing the national standards is the duty of the state. As a means for realizing this principle of the Constitution, the Law Concerning the National Standardization was established and promulgated on February 8, 1992, which requires the development of a series of five-year basic plans for national standardization. The second Five-year Basic Plan for National Standardization was developed to provide strategic direction for the 2006–2010 period (Korokawa T. (2006), “Developing Human Resources for International Standards”).

[45] The Japan Economic Foundation (2008), *GLOBALIZATION GA SEKAI OYOBI NIHON KEIZAI NI ATAERU EIKYOU NI KANSURU CHOUSA KENKYUU*

[46] The Japan Economic Foundation (2008). Same as above.

[47] European Computer Manufacturer Association

[48] Joint Technical Committee of ISO and IEC on information technologies

companies. Japanese companies succeeded in incorporating the pigment material, a basic material upon which the record type-DVD record layer is constructed, into the 4.75GB DVD-R and RVR+R media global standards. Due to these reasons, all DVD manufacturers in the world must use the pigment material, of which the company holds a patent, to produce DVD media. In the DVD technology fields, other intellectual properties such as polycarbonate resin, high-power semiconductor laser, LSI chipset, and small-sized ultra precision motor and aspheric bifocal lens have also been successfully incorporated into the global standards by Japanese companies[49].

In fields other than DVD, Japanese companies in many industries, such as communication equipment and electric appliances, have successfully incorporated their patented technologies into the global standards, substantially contributing to improving the balance of payments for patent licenses in Japan.

(Conclusion)

In the above sections, for each of the value chain functions, we discussed the issues involved when Japanese companies expand and enhance their businesses in the fast growing emerging countries' markets. The use of external management resources is a key strategy for responding to increasingly fast-changing market environment. Moreover, the initiatives related to intangible assets, such securing human resources, authority delegation, M&As and strategic partnerships, and achieving global standards, were reviewed. To enhance their profitability in the future, it is important for Japanese companies to build new business models where these initiatives are incorporated and utilized in flexible combination with variety of management resources, which will enable them to create new values. Companies should seek to develop new business models from a broad perspective, and excess customizations should be avoided[50].

2. New market creation by global business development by "domestic market oriented" industries[51]

In the past, in "domestic market oriented" service industries such as distribution industry and infrastructure intensive industry, companies did not look toward developing overseas businesses. The reasons for this include: (1) expected large scale domestic demand, assuming a constant economic growth; (2) "short lag time between manufacture and consumption" in the service industry; and (3) existence of substantive entry barriers such as variety of regulations and differences in business practices in other countries.

However, in recent years, companies in the "domestic market oriented" industries are faced with

49 Research Group on Economy of Standardization (2006), *International Competition and Global Standard*

50 For example, in "ARCHITECTURE BUNSEKI NI MOTOZUKU NIHON KIGYOU NO KYOUSOU SENRYAKU" (Shintaku J., 2005), the importance of considering strategies in which "creative and original use of general purpose products" and "modular type customization" is emphasized, rather than "extreme customization" or "lower-cost mass production."

51 Reference material on the Asian Gateway Initiative (http://www.kantei.go.jp/jp/singi/asia/kousou.pdf, Japanese only) contains a discussion on "domestic market oriented industries."

increasing necessity and possibilities for developing overseas businesses due to the following factors: (1) increasingly saturated domestic market[52] due to declining birth rate and aging population, and emergence of fast-growing markets across the emerging nations in Asia and other regions in the world; (2) technological innovations in distribution processes and in the IT field; and (3) increased accessibility to domestic and overseas markets resulting from loosened trade restrictions via EPA/FTA and WTO.

In this business environment, the global expansion by companies in service industries such as distribution industry and infrastructure intensive industry, which was enabled by the enhanced "customer contact functions," could serve as a catalyst to develop new international value chains. The newly formed value chains will promote the market expansion of Japanese consumer and capital goods industries, which have been striving to develop overseas markets. From the abovementioned point of view, we will discuss the overseas business development by the "domestic market oriented" industries, and the resulting potential for value creation. In the following sections, we will see examples of the "lifestyle solutions" business in the retail industry and the "solutions provider" business in the infrastructure intensive industry.

(1) Retailers' overseas business development: strategy change from single product sale to lifestyle solutions

(Lifestyle solutions business developing new markets through value creation)

While domestic markets are contracting, as discussed in Section 1 of this chapter, in rapidly growing countries in Asia and other emerging countries, there are an increasing number of consumers, primarily in the "urban middle class[53]," both with buying power and with a consumption orientation similar to that of Japanese consumers. Retailers and service providers targeting individuals, who have direct contact with consumers, offer consumers a new lifestyle and sense of values as they provide goods, contents, and services, creating and expanding new markets. We call these "lifestyle solutions business[54]."

Case 1: Emerging "urban middle class" in the Middle East—Dubai

In recent years, in addition to Asian countries, the Middle East oil producing countries, whose economies—fueled by continuously rising resource prices—have been growing, are experiencing the emergence of the urban middle class. In particular, Dubai, the business capital of the United Arab Emirates, is a relatively small city with a population of 1.42 million (as of 2006); however, its GDP

[52] The total sales of retail industry in Japan declined by 10 trillion yen—from 145 trillion yen to 135 trillion yen between 1996 and 2007 (METI, "Census of Commerce").

[53] According to the Council on East Asian Community (2005), the "urban middle class" is defined as "well off people who share common elements in such areas as income, school education, home, hobbies, international aspect of business and traveling abroad regardless of their countries or regions, and have substantially different lifestyles and values from those of their parents' generation (although there are differences among countries and regions)."

[54] Content businesses also play a big role in developing markets. As reflected in the old U.S. saying "Trade follows the film," they generate significant ripple effects, appealing directly to consumers and offering them a new lifestyle and sense of values.

growth ratio since 2000 has been 20% p.a. Its GDP per capita of 31,140 dollars is comparable to that of Japan. Furthermore, this city serves as a center of the Middle East and the Islamic world, where people, goods, and money gather and interact. It is the key city in business development in the Middle East[55].

For Japanese companies, securing presence in Dubai, which serves as a business hub positioned between Europe, the Middle East, and Asia, is extremely important for developing their businesses in the entire Middle East market. Japanese companies such as Daiso-sangyo, which operates hundred yen shops, and Yellow Hat Ltd., which sells automotive parts and provides related services, have developed businesses in Dubai, meeting the specific needs of the local market. They have successfully established their reputations and differentiated themselves from other local companies with their lower prices and higher quality of services. Both these companies promote themselves as Japanese companies as a part of their branding strategies. Their merchandises include those with descriptions in Japanese[56], which provoke images of being high quality, safe, and secure; these are common characteristics of Japanese products and services.

(Lifestyle solutions businesses that are spearheading the consumer goods industry's overseas business development)

The lifestyle solutions businesses, especially retail shops located abroad, are serving as an excellent "marketing channel" for Japanese companies in the consumer goods industry. They are also serving as an originating point of the "demand chain," which forwards the demand information obtained from consumers to manufacturers. These overseas retail shops strive to expand the overseas market and simultaneously provide feedback from overseas consumers to help improve their products[57]. Moreover, when Japanese companies in the distribution industry develop their overseas businesses, the concern about the collection of receivables held by the consumer goods industry, which supplies their products to distribution industry companies, could be alleviated[58].

In response to these newly developed markets, Japanese retailers are actively building their overseas businesses in China, Southeast Asia, and other regions, offering differentiated products and services from local companies[59]. The overseas business development of lifestyle solutions businesses,

55 For example, the number of transit passengers using Dubai Airport is 23.8 million people a year, and the number of stay-over tourists is 6.5 million people a year. Looking at the number of tourists by country, we see that they are from diverse regions with 30% from the Middle East, 30% from Europe, and 20% from Asia. The container handling volume at the Dubai Port is far greater than those of any other major ports in the Middle East. From the breakdown of import and export by country, we can see the flow of goods. Goods imported from China and developed countries go through Dubai and then on to the surrounding Middle East countries. People, goods, and money gather and interact in Dubai.

56 This is a good example of a Japanese retailer of consumer goods developing overseas market, which will be described later.

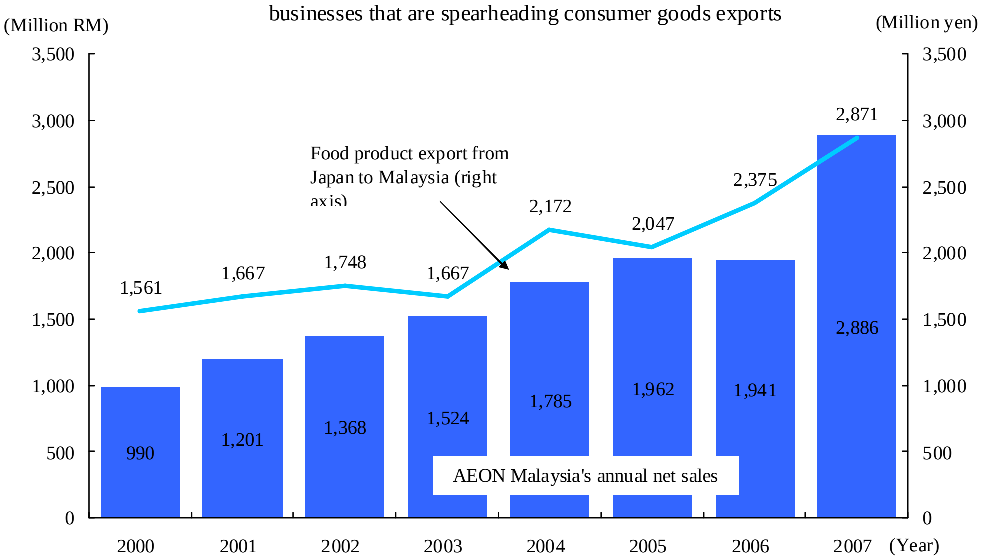
57 Reduced information transmission cost from IT innovation has contributed to enhancing the feedback function.

58 Most of the companies, primarily small and medium-sized enterprises, are concerned with the collection of receivables when they start overseas businesses. See Section 3 of this chapter.

59 For example, net sales of AEON Malaysia (overseas subsidiary) quadrupled from 680 million RM

which have direct contact with local consumers, is expected to promote the overseas business development of companies in the “domestic market oriented” industries (see Figure 2-3-31).

Figure 2-3-31 Overseas business development by lifestyle solutions businesses that are spearheading consumer goods exports



Note: Figures used for food product export from Japan to Malaysia are those of "food and live animals" export item. AEON Malaysia's 2006 annual net sales figure is for ten months due to the change in the fiscal year-end.
Sources: Ministry of Finance, *Trade Statistics of Japan* ; AEON Malaysia, *Annual Report* .

Case 2: Example of retailers developing overseas businesses

Historically, the retail industry was closely tied to local communities, and local companies had competitive advantages with their businesses, which were deeply rooted in the local culture. However, in recent years, retail companies have started to expand their businesses abroad. In particular, some large retail companies not only procure goods from overseas but also strategically develop retail stores in foreign markets.

For example, GMSs[60] such as AEON Co., Ltd., Ito-Yokado Co., Ltd., and UNY Co., Ltd. plan to aggressively promote business development in China[61]. Moreover, convenience stores such as FamilyMart Co., Ltd., LAWSON Inc., and Seven-Eleven Japan Co., Ltd. have plans to strengthen their businesses in Asia[62]. In the department store sector, since the opening of Takashimaya New York in 1958, Mitsukoshi Ltd., Daimaru Inc., and other department stores have opened stores in major foreign cities, primarily in the United States, which is visited by many Japanese tourists. In addition to

(Malaysia Ringgit) in 1998 when operations started, to 2,890 million RM in 2007 (AEON Malaysia annual report).

60 General Merchandise Stores.

61 AEON Co., Ltd. announced its plan to open about 100 stores, mostly large-scale shopping centers, in China, and build a network of about 90 stores in South East Asia by 2010. Ito-Yokado Co., Ltd. announced that it will increase the number of its stores in China from 12 to 17 in 2008. UNY Co., Ltd. plans to develop and expand business in China by 2011.

62 FamilyMart Co., Ltd. plans to double the number of stores in Southeast Asia and the United States from the current 6,600, targeting to have 20 thousand stores in the world. LAWSON Inc., which had 287 stores in Shanghai as of the end of 2007, plans to focus on opening stores in China from now on. Furthermore, Seven-Eleven Japan Co., Ltd. plans to start franchise development in Shanghai in 2008, following the development in Beijing, China.

opening stores in European and US cities with many Japanese tourists, Japanese department stores have begun to actively develop businesses in Asia[63] in recent years. In addition, shopping centers, whose business style is relatively new, and SPAs[64], which manufacture and distribute their own products, have started developing their businesses overseas. Marui Group Co., Ltd., Parco Co., Ltd., and Ryohin Keikaku Co., Ltd. that operate MUJI and Fast Retailing Co., Ltd. that operates UNIQLO are the representatives of these businesses[65].

[Column 11]　Cross-border B to C electric commerce

There are two main ways to develop overseas business: (1) actually setting up retail shops in overseas locations to supply products and (2) operating a mail order business for overseas consumers. The latter business works well with the Internet (Internet mail order system), due to its accessibility at any time from any location in the world. A combination of the Internet and direct contact marketing activities is an effective way to promote business opportunities. For example, a Japanese company may hold short-time sales promotions for Japanese products at foreign department stores; after the sales promotions, the company can follow up and supply products by utilizing the Internet mail order system. This kind of efforts will help develop and expand overseas markets for Japanese consumer industry companies.

The United States and other Western companies have been leaders in the global mail order business. However, in recent years, companies in Japan and other Asian countries have been aggressively pursuing their overseas development.

A good example of this type of company is Rakuten Inc., which operates an online shopping mall. The company started businesses in Taiwan and Europe in 2007 and 2008, respectively. In addition, Senshukai Co., Ltd. in Japan, which operates a mail order business via the Internet and a catalogue, launched a business in Shanghai, China. Marui Group Co., Ltd., a clothing retailer, launched the "Cool Japan" mail order website for international customers. Yahoo Japan Corporation, the largest auction site operator in Japan, formed a partnership with the US company e-Bay Inc. In Asia, Alibaba Group, a

63 Isetan Company Limited already has 13 stores in China (Shanghai, Tianjin, Chengdu, and Shenyang), Thailand, Singapore, Malaysia, etc.

64 SPA (Specialty store retailer of Private label Apparel) originally referred to an apparel business that covered everything from manufacturing to retail. However, now in many cases, SPA refers to any business that covers manufacturing to retail.

65 Marui Group Co., Ltd., which operates a fashion retail business primarily in the metropolitan Tokyo area, opened its first overseas store in March 2008, as a tenant in a Hong Kong-based department store in Shanghai. Parco Co., Ltd., which targets young consumers and has already started its business in Singapore in 1995, has a strategic plan to continue developing stores in the East Asian region. Ryohin Keikaku Co., Ltd., which operates MUJI in Japan, has 82 MUJI brand stores in overseas markets. The company strategically opened stores in the trend setting areas of the cutting-edge cities such as London, Paris, and Hong Kong to enhance their products' brand image. In New York, Ryohin Keikaku Co., Ltd. has one store in the Soho area and a flagship store in the New York Times Building, successfully establishing a stylish brand image. Moreover, Fast Retailing Co., Ltd., which operates UNIQLO brand shops in Japan, started to open shops in Asia in 2001. The company now has 30 shops in China, Hong Kong, and Republic of Korea. In its strategic plan, Fast Retailing Co., Ltd. aims to establish its global brand positioning, opening flagship shops in the key cutting-edge cities in Europe and United States.

Chinese operator of a B-to-B e-commerce site and an online auction site for consumers, set up a joint venture company with SoftBank Corp. in May 2008, to develop business in Japan.

These Internet mail order business operators are faced with challenges. Although they can conduct marketing in virtual space via the Internet, products need to be physically delivered when they are sold. For this reason, regulations on clearance and logistics and undeveloped infrastructures act as problems, which are shared with regular retailers. Challenges that are unique to the Internet mail order business operators include putting in more efforts to earn trust and recognition from customers compared to regular retailers and enhancing search engine marketing capabilities.

In order to address these challenges, the Ministry of Economy, Trade and Industry launched a plan to establish “Asia Electronic Distribution Block,” a borderless distribution network that ensures high reliability and usability.

(Issues on overseas business development remain in both in software and hardware areas)

According to hearings from Japanese distributors conducted by the Ministry of Economy, Trade and Industry, the following were pointed out as major issues.

○ Regulations on foreign companies’ entry, etc.

The first possible problem for a Japanese distributor entering an overseas market is the barriers in the country’s regulatory systems. For example, regulations limiting foreign capital and/or restrictions on location and hours of operation could serve as major hindrances to the business activities of Japanese companies operating in the relevant market[66]. Moreover, many countries have restrictions on goods that are allowed to be traded by foreign retailers, which serve as serious practical hindrances to business activities in markets of relative countries.

○ Lack of transparency in implementation of laws and regulations

The second possible problem is the lack of transparency in the implementation of laws and regulations. For example, when foreign companies apply for government approval or permits, they sometimes need to wait for a longer time or they receive unreasonable administrative instructions. In some cases, local governments require registration for the establishment of each store with the purpose of earning more registration fee income. This kind of regulatory system substantially damages the benefits incurred from advantages of scale through chain store development, which is a typical business model for retailers. Moreover, adjustment of retail businesses, which is one of the local

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[66] For example, in principle, the Indian government prohibits foreign retailers from entering the country’s market, except when a foreign retailer carries only one brand (single-brand retailing) and obtains approval from the government. Under this regulation, a foreign retailer needs to use one single brand throughout the world and is allowed to sell only products on which the brand name is printed when they are manufactured. In reality, foreign retailers, who usually carry a variety of products, cannot enter the Indian market due to this regulation. In Indonesia, there are regulations on foreign enterprises’ operations, such as restrictions on floor areas and the type of operations allowed. These regulations discourage foreign businesses, particularly convenience store operators, from entering the market.

governments' measures to protect local retail businesses, and frequent regulatory changes are risk factors for foreign companies.

In countries where workers are well protected by labor laws and regulations, such restrictions on termination of employment, minimum wage, or closing of stores could become a heavy burden. In addition, foreign businesses might suffer high added value taxes for service provision, arbitrary taxation resulting from undeveloped taxation systems, or disadvantages from tax and accounting issues related to franchise development[67].

○ Difference in business practices, etc.

The third possible problem is the imitation of trademarks, brand names, and services, as well as the flood of counterfeit products. These are major potential hindrances to business development. Accidents with counterfeit products could harm the reputation of the original product manufacturers. This risk factor should be addressed quickly; however, measures undertaken by the governments have not been effective enough.

Moreover, in some countries, commissions and rebates have become everyday business practices. In purchasing and distributing products, companies need to pay additional money besides the amount stated in the contract. In addition, tax offices, police departments, permit issuing authorities, and other governmental organizations demand fees or other compensations. Refusal of payment sometimes results in business interruptions by the authorities.

○ Insufficient local infrastructures for providing services

The fourth possible problem is the insufficient local infrastructure that is required to provide goods and services. Underdeveloped logistics infrastructures such as ports, railways, roads, and low temperature distribution networks; information infrastructures including the Internet; life-line infrastructures such as electric power, gas, and water as well as safety and security issues could pose a problem.

○ Locally securing capable human resources

The fifth possible problem is the unavailability of human resources, particularly middle managers who would lead and supervise the local business development. Communication problems between domestic and overseas bases, primarily due to insufficient language proficiency, as well as high turnover of trained personnel are also problems[68].

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[67] For example, the Indonesian labor regulations do not allow the employer to terminate an employee even with good reason such as a theft, unless he or she agrees and receives reasonable dismissal allowance. Moreover, in the Philippines, when a worker is employed for six months or more, he or she becomes a regular employee. Considering the high employee turnover rate in the country, this is a major risk factor in terms of investing in employee training programs or making a strategic decision whether to open or close stores. In China, the efficient and effective franchise accounting systems cannot be implemented, due to differences in tax and accounting procedures and legal regulations. In some countries, overwhelming tax-filing paperwork requirements, and vague and arbitrary taxation practices are costing foreign retailers extra expenses as well as giving them disadvantages in their competition with local retail businesses.

[68] Discussed in Section 1 of this chapter.

(Need for measures to promote overseas business development by lifestyle solutions businesses)

Lifestyle solutions businesses have spearheaded the overseas business development of the consumer goods industry, thus contributing to the development of the industry. Therefore, measures are required to further promote their overseas business development.

The following measures are considered effective for the promotion of their overseas business development: (1) easing regulations through trade negotiations (take advantage of EPA/FTA and/or investment agreements); (2) providing information on target countries' systems, etc., (overview of laws and regulations, how they are implemented, business practices such as collection of receivables) and information on local consumer markets (local consumer's preferences and behaviors, etc.); (3) providing support for hiring and training local staff (help train local staff by sending experts and/or providing technological assistance[69]); and (4) conducting top sales (Japanese government's top leaders and business's top leaders directly contact the target countries' leaders and high officials for talks[70]). In addition, support initiatives such as supplying information on foreign markets and other companies' initiatives, and providing know-how on overseas business development through seminars and individual consulting, which have been mainly offered to manufacturers, should be enhanced to meet the needs of lifestyle solutions businesses, thereby providing them with useful and usable information.

(2) Infrastructure intensive industry's overseas business development: strategy change from equipment sales to total solutions provision

(Solutions provider business developing new markets through provision of total solutions)

In the emerging countries, infrastructure development has not caught up with the rapid pace of economic growth. The development of infrastructures such as electric power, transportation, water and sewage works is necessary for sustainable development and for addressing environmental and resources problems, which slow down economic growth. The World Bank identified this issue of undeveloped infrastructures in emerging countries as one of the causes of income disparities[71]. To

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[69] Currently, organizations such as JETRO (Japan External Trade Organization) and SMRJ (Organization for Small & Medium Enterprises and Regional Innovation, Japan) hold seminars on foreign investment and offer personnel training programs, individual consultation on business development, and guidance and instructions of experts.

[70] "Top sales" is often used in Europe and US countries. In the top sales talks, leaders tell the target country's leaders and high officials how their country's companies can contribute to the enhancement of target country's consumers' lives, and also strongly ask for improvements in the target country's structural and legal problems. See Section 4 of Chapter 4 for details.

[71] In its survey, the World Bank divided the developing countries into low-income countries and middle-income countries, and further divided the middle-income countries into two categories, namely lower middle-income countries (per capita GNI of between 766 dollars and 3,035 dollars, 2003) and upper middle-income countries (between 3,036 dollars and 9,385 dollars), to find out the ratio of people who have access to infrastructures such as electric power, water, communication, and transportation in each category. The survey results revealed that there were huge gaps in the ratios between upper middle-income countries, lower middle-income countries, and low-income countries (for example, the ratios of people who have access to communication infrastructure in the abovementioned three groups were 54%, 22%, and 5% respectively; target survey population: urban residents). The World Bank pointed out that global income disparities are caused by differences in absolute quantities of infrastructure.

realize economic growth, these serious problems need to be addressed[72]. Most of these problems are those that Japan already faced and overcame in the 1970s. Japan should use its experience and know-how gained during this period. Japanese electric power companies and other companies in the infrastructure intensive industry, which are capable of addressing these problems, can be regarded as "solutions providers."

(Active overseas business development by solutions provider businesses targeting emerging countries' markets[73])

To meet the increasing demand for infrastructure, the governments of emerging countries, which cannot afford to entirely finance their infrastructure development projects on their own, began to encourage participation from the private sector. The involvement of the private sector began to grow rapidly in the 1990s[74]. In this environment, companies in Europe and United States have been involved in the infrastructure development projects, achieving lower cost operations. Understanding the characteristics of the infrastructure intensive industry businesses, they offered development and effective management of the whole value chain. In particular, they are engaged not only in EPC projects[75] such as infrastructure construction but also in a wide range of activities including infrastructure operation and maintenance (O&M[76]) and financing. As a result, they have successfully expanded their businesses, including telecommunications and water utility businesses in emerging countries[77].

The infrastructure markets in emerging countries are huge. According to the World Bank, the infrastructure development demand (including maintenance and operation) in the East Asian region between 2005 and 2010 will reach 200 billion dollars a year. However, the overseas business development of the Japanese solutions providers is lagging behind that of European and US companies. Only a limited number of companies[78] such as general trading companies and electric power companies[79] have been engaged in the overseas businesses. The overseas business development by

[72] Considering the abovementioned income disparity problems, the World Bank started to focus on poverty reduction in the 1990s; in 2005, it developed a concept of "inclusive development," in which linkages between infrastructure construction and poverty reduction as well as economic growth is emphasized.

[73] Kaga R. (2007), "PROJECT FINANCE NO JITSUMU"

[74] Another factor behind the increase of private sector involvement is that the "Structural Adjustment Programmes" by IMF and World Bank started to require the emerging countries' governments to include programs such as "privatization of government-owned enterprises" and "private sector development."

[75] Construction contractor business including engineering, procurement, and construction.

[76] Consignment business of operation, maintenance, and other services.

[77] See Chapter 4 for further discussion on the water utility business, in which privatization is advancing, and on the mobile phone business in Africa, where foreign companies are developing their businesses.

[78] According to hearings from Japanese businesses conducted by the Ministry of Economy, Trade and Industry, there are environmental equipment and plant manufacturers that not only manufacture and sell equipment and plant manufacturers but work on providing total system solutions including related services.

[79] General trading companies initially regarded the power generation business as a supplemental business attached to exports of machinery and equipment. However, in later years, they became fully engaged in the power generation business. The total power generation by projects, in which the seven general trading companies are involved, reached 17,442 MW in May 2007. This power generation capacity is close to 20,488 MW of AES (U.S.), the third-largest power generating company in the world (The first is 26,424 MW of EDF [France]; as of December 2006).

Moreover, in the domestic business environment, where demand growth for electric power is decreasing, Japanese electric power companies view the overseas power generation business as a new business these solutions providers is contributing to mitigating the business concerns of the capital goods industries, such as the trouble of managing intellectual property rights. Encouraged and supported by this, it is expected that plant and industrial machinery manufacturers and other businesses in the capital goods industries will further expand their overseas business development.

(Lack of business entities that possess and provide services and know-how—the greatest challenge to overseas business development)

○ Insufficient know-how to develop and manage the entire value chain

First, the major challenge to overseas business development by solutions provider businesses is the insufficiency of know-how accumulation, which is required to develop and manage the entire value chain.

One of the factors behind this is the inadequate progress of risk transfer from the public sector to the private sector. Therefore, private sector companies have not had much experience of bearing risks, and there are no business entities that are capable of managing the entire value chain. The risks involved in infrastructure investment can be classified into the following five categories[80]: "risks related to construction,"[81] "risks related to operations,"[82] "risks related to market conditions,"[83] "country risks,"[84] and "force majeure."[85] Currently, in many industries[86], the risk transfer from the

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opportunity, in which they can utilize their abilities and experience accumulated in Japan. Five companies are now fully engaged in the overseas businesses, and their total power generation capacity has reached 7,934 MW.

80 This classification is taken from the "HEISEI 19 NENDO KAKKOKU TOUSHI KANKYOU KANREN NO HOUSEIDO/KISEI TOU NI KANSURU KISO CHOUSA TOU (KAIHATSU KINYU NI OKERU ARATANA KANOUSEI NI KANSURU CHOUSA)" compiled by the Nomura Research Institute. In a narrow sense, "exchange rate fluctuation risk" could be classified under "risks related to market conditions." However, in the infrastructure intensive industry, country specific factors could cause changes to exchange rates, and in turn affect project profitability. For this reason, it is classified under "country risks."

81 These risks include "cost overrun risk" (risk of spending more money than originally budgeted) and "risk of delay" (risk of spending longer operation period than initially scheduled).

82 These risks include "risk of facility damage" (risk of temporary operation shutdown due to damage to facilities), "labor risk" (risk of incurring additional costs and operation shutdown due to labor related reasons), "operation risk" (risk of inappropriate operations resulting from operators' lack of technical and managerial capabilities), and "third party damage compensation risk" (risk of causing damage to third party during operation and incurring claims for damage compensation).

83 These risks include "demand fluctuation risk" (risk of sales deviation from planned sales levels), "price fluctuation risk" (risk of cost changes in equipment, material, and labor due to inflation or deflation), "interest rate fluctuation risk" (risk of increased interest payment due to increase in interest rate during operation), and "raw materials risk" (risk of unavailability of raw materials that are essential to operation).

84 These risks include "exchange rate fluctuation risk" (risk of suffering foreign exchange losses), "neighboring residents risk" (risk of facing oppositions from local communities where a company operates), "risk of changes in laws and regulations" (risk of changes in laws, regulations, and systems that will have adverse effects on investors), "expropriation risk" (risk of expropriation of business and/or assets by governments or local authorities), "foreign remittance risk" (risk that investors become unable to remit income earned in operating companies back to home countries), and "default risk" (risk that local governments do not provide cooperation needed to execute operation).

85 These risks include "natural disaster risk" (risk of business interruption due to natural disasters, etc.).

86 Private-sector vitality utilization in Japanese infrastructure development has been mainly through the "BTO (Build Transfer Operate)" arrangement, in which only construction related risks are transferred to the private sector. In contrast, in the "BOT (Build Operate Transfer)" arrangement, risks related to operations

public sector to the private sector has been limited only to the area of “risks related to construction.” Private sector companies do not have much opportunity to bear “risks related to operations” and “risks related to market conditions.” As described above, the risk transfer from the public sector to the private sector has not covered all functions of the entire value chain, resulting in a lack of business entities that can provide know-how.

○ Underdevelopment of financing infrastructure, which would contribute to risk diversification

The second major challenge is the underdevelopment of the infrastructure for financing business development. Looking at infrastructure projects from the income structure point of view, there are two stages: the first five years from the launch of the project when project risk is high and the later period, when a stable income can be secured and project risk is lower. Due to its unique characteristics of infrastructure businesses, infrastructure projects require a longer period to recover the investment, and expected returns from the projects are different for each of the two stages. As a result, each stage needs different financing arrangements; the first stage needs a risk-bearing financing and public sector financing for mitigating the risk, while the second stage should call for stable financing from financial institutions, such as pension funds. However, these financing methods are not always available, and capital markets that meet the needs of the infrastructure businesses have not been established.

○ Lack of entities that provide risk-bearing financing

The third challenge is the lack of financing entities. In the United Kingdom and Australia, pension funds and other institutional investors are playing a major role in financing infrastructure projects, by using money invested by individuals in financial assets to finance projects. In Japan, however, pension funds and other institutional investors have not played a prominent role.

[Column 12] Risk transfer and sophistication of infrastructure financing in the United Kingdom and other countries

In this section, we will introduce an advanced example of infrastructure financing in the United Kingdom and other countries, including the manner in which financing systems were developed.

In the United Kingdom, the privatization programs started in the 1980s by the Thatcher administration were continued and developed. With the goals of achieving fiscal soundness and improving service quality of public sector facilities, the government promoted the use of outsourcing, PFI[87], and PPP[88] to facilitate private sector financing.

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and market conditions are also transferred to the private sector.

[87] PFI (Private Finance Initiative) is a method to utilize funds, management, and technical capabilities of private sectors to build, manage, maintain, and administer public facilities, etc. (Cabinet Office, Government of Japan website http://www8.cao.go.jp/pfi/aboutpfi.html).

[88] PPP (Public Private Partnership) is a wider concept than PFI. PPP aims to introduce market mechanisms into public services through measures such as outsourcing to private companies, PFI, transformation into independent administrative institutions, and privatization, to enhance the efficiency of public services. PFI

In the United Kingdom, PFI projects, government organizations, and municipal governments were required to design systems in which risk transfer from the public sector to the private sector could be achieved not only in the area of "risks related to construction" but also in the areas of "risks related to operations" and "risks related to market conditions." This helped achieve the improvement of risk control, in other words, it achieved risk diversification and flexible use of capital market depending on the risk levels. With the public sector offering the private sector a large volume of investment opportunities in a well-planned manner, including PFIs with built-in risk transfer mechanism, the private sector infrastructure businesses and the infrastructure investment market expanded rapidly.

In this way, the UK infrastructure projects, including operations, were opened to private sector participation through arrangements such as PFI, enabling private sectors to improve financing methods, as well as to bear and control not only "risks related to construction" but also "risks related to operations" and "risks related to market conditions" in the infrastructure businesses. These experiences and know-how gained from domestic projects have been utilized in overseas business development. Similar examples are found in other countries such as France and Australia. In the United Kingdom and Australia, the infrastructure business is seen as an attractive target for pension fund investments owing to the stable income it generates. The capital market structures for financing infrastructure projects, including private placements or public listings, developed accordingly.

(Need for measures to promote overseas business development by solutions provider businesses)

The infrastructure market—a target market for solutions provider businesses—is expected to continue growing, primarily in the emerging countries. Measures to encourage the overseas development of these markets are required.

The key to achieving this is to find out how Japan can cultivate the entities that possess and provide services and know-how to develop and manage the entire value chain as well as how it can develop the capital market and foster investors to help cultivate these entities. Public and private sectors should address these challenges together.

Promoting the risk transfer from the public sector to the private sector is an effective way for cultivating entities that are capable of managing the entire value chain. To realize the risk transfer, high level capability and creativity in system designing are required on the part of the government. Therefore, the deployment of systems and measures, including further revisions to the administrative guidelines, to promote the use of BOT/PFI[89] arrangements by government organizations and municipal governments is expected.

Moreover, developing the capital market and fostering investors share a "chicken and egg relationship." Reviewing the establishment and development of REIT (Real Estate Investment Trust) in the real estate industry, which was in conditions similar to the infrastructure industry, would be helpful. The development of a system in which the market and investors can interact and help each

is a form of PPP.

89 Description of BOT is in footnote 86.

other grow is expected.

3. New market creation via global business development by small and medium-sized enterprises (SMEs)

As seen in the previous section, in the past, global business development has been carried out mainly by large companies. However, in recent years, an increased number of SMEs have also been engaged in global business, and many of them have increased both their revenue and income. More companies are considering global development[90]; on the other hand, in core industries—such as the "mold-manufacturing industry," where Japanese companies have developed specialties—imports of general-purpose, low-added-value products have been increasing[91].

In this business environment, Japanese SMEs are expected not only to provide products and services that are distinctive and unique, but also to participate proactively in creating global value chains. From this perspective, in the following section, we will describe the current conditions of global business development by SMEs in the midst of increasing globalization, and introduce some advanced companies that have started their strategic market development and have been creating value; we will also discuss the risks and issues inherent in SME global business development.

(1) Overseas business development: SMEs re-routing business, away from large companies and to self-directed enterprises

In examining the history of Japanese SME global business development, we see that direct foreign investment made therein—which was not seen until the 1970s—started to grow increasingly around the time of the Plaza Accord in 1985. This growth was spearheaded by medium-sized parts manufacturers that went overseas, in response to requests from large client companies that were actively making direct foreign investments. This growth was further accelerated following the burst of the 1990s economic bubble. One of the major factors underpinning this development was the fact that SMEs—which were faced with a contraction in domestic demand, due to large companies' shift to overseas production bases—independently chose to develop their overseas businesses[92]. Ultimately, the growth ratios of SMEs' overseas business development might have been greater than those of large companies[93].

(2) Strategic objectives are changing from reducing costs to developing local markets

Reflecting changes in the conditions of SME global business development, SMEs' strategic objectives are changing. When SMEs initially started to develop business overseas, about 40% of companies cited a manufacturing cost reduction by using cheaper labor as an element in their overseas development; only a little over 10% cited a desire to develop overseas markets as a primary motivator.

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[90] See Section 2 of this Chapter.

[91] METI (2007), *White Paper on Monodzukuri 2007*.

[92] For details, see METI (2006), *White Paper on Small and Medium Enterprises in Japan 2006*.

[93] Actually, the number of SMEs with overseas subsidiaries increased 60%, from 2000 to 2005 (that of large companies grew a little over 30%). (METI, "Basic Survey on Overseas Business Activities"; in the survey, an "SME" is defined as a firm with capital of ¥300 million or less).

However, the ratio of companies aiming to reduce costs through overseas manufacturing has decreased to 30%, while that of companies seeking to develop overseas markets has grown to about 30%—twice as much as ratio at the time of initial overseas development[94].

These changes reflect the fact that Japanese SMEs have started to participate fully in global value chains, by securing direct contacts with customers for promoting products and services in overseas markets[95]. As discussed in Section 1 of this Chapter, for SMEs to participate actively in global value chains and create value, they need to provide distinctive and unique products and services. In their global business development efforts—including the export of products—SMEs' creative approaches seem to have contributed to enhancements in both their labor productivity[96] and their products' added value[97].

(New trends in overseas market development)

Some Japanese SMEs have successfully developed overseas markets by providing distinctive and unique products and services and proactively establishing global value chains and strong market positions. The following cases are examples where a difficult situation was made into a business opportunity. In the textile industry, which faces threats from globalization and pressures to adjust structurally[98], the companies discussed below actively developed their overseas businesses.

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[94] Mitsubishi UFJ Research and Consulting, "SAIKIN NO SEIZOUGYOU WO MEGURU TORIHIKI KANKYOU HENKA NO JITTAI NI KAKARU ANKEETO CHOUSA" (conducted in November 2005).

[95] On May 31 and June 1, 2007, the Ministry of Economy, Trade and Industry and the OECD co-hosted the "OECD Global Conference" in Tokyo, to discuss issues concerning the globalization of SMEs. The theme of the conference was "Enhancing the Role of SMEs in the Global Value Chain (GVC)." The "Tokyo Communiqué" was adopted during the Conference; it included policy recommendations for promoting SMEs' beneficial participation in the GVC: (1) raising awareness of GVC participation; (2) promoting participation in GVC, through enhanced partnership and cooperation among SMEs; (3) improving regional technological innovation capabilities; (4) enhancing corporate value through the appropriate management of intellectual assets; and (5) supporting standard certification compliance.

[96] METI (2008), *White Paper on Small and Medium Enterprises in Japan 2008*. See Figures 2-4-9 and 2-4-10.

[97] It is expected that SMEs will generate creative approaches in promoting their products and services in domestic and international markets. (METI [2008], *White Paper on Small and Medium Enterprises in Japan 2008*).

[98] The present business environment of the textile industry is becoming increasingly challenging, due to such factors as an increase in imports of cheaper products from abroad and the contraction of the domestic market due to a decreasing population. In the midst of this environment, there is an increasing number of companies among small and medium-sized textile companies that are tackling such challenges and developing overseas markets, through the use of high-level technologies. We see that, among companies that do not currently have overseas operations, there are many that are considering an expansion to foreign markets. About 40% of respondents from the textile industry said they intend either to actively pursue overseas business opportunities or to do so in the future (survey on the conditions of industrial production areas conducted by the Nomura Research Institute [January 2008]). At the same time, it is true that, even if they wish to develop overseas businesses, most SMEs do not possess the required capital or knowledge. Two of the presented cases are from the Fukui Prefecture, which provides information and holds trade fairs, exhibitions, and business meetings to support overseas business development by companies located in the Prefecture.

Case 1: Market development by establishing direct contact with customers (Shindo Senikogyo Co., Ltd.)

Shindo Senikogyo Co., Ltd. (headquarters: Fukui Prefecture; number of employees: 292; capital: ¥30 million) comprehensively designs and manufactures women's clothing and textile materials. Faced with a gradual contraction of domestic demand in the textile industry, the company launched its first original brand, SIC (SHINDO ITEM CATALOGUE), in 2002. Under the SIC brand, the company markets a rich array of products, such as ribbons and tape, for a total of about 34,000 items. The company's business performance has been strong.

The strength of the company is its collection of original brand showrooms, located in key fashion capitals (e.g., Tokyo, Paris, New York, and Shanghai). These showrooms provide opportunities for direct contact with customers, enabling the company to promptly adopt the most recent fashion trends and manifest them in its product development. The company distributes its product catalogues to designers throughout the world, to promote its products; furthermore, it has established a system by which customers can purchase the company's products at their desired time and in their desired amounts, thus fully meeting the customers' needs. As a result of the company's creative marketing efforts, top brand names such as Dior, PRADA, FERRAGAMO, and BURBERRY now showcase the company's products.

Case 2: Market development by using materials technology (Daiichi Orimono Co., Ltd.)

Daiichi Orimono Co., Ltd. (headquarters: Fukui Prefecture; number of employees: 51; capital: ¥10 million) is engaged in the contract manufacturer of industrial textile materials—such as sailcloth for yacht sails—using high-density fabric weaving technology.

The company used its assets in high-density fabric weaving technology to develop highly functional sportswear possessing excellent water-repellent, waterproof, and breathable properties. The company expanded its marketing efforts to promote its product in 1996, and started exporting products overseas in 1998.

In its international marketing, the company places importance on its relationships with clients. The president and agents visit the clients directly, to listen to their requests and obtain feedback on the company's products. That feedback has been used to develop new materials. Products are sold solely through the agent designated to each region; no other parties are allowed to conduct sales activities there. This sales system has been effective in keeping the prices at high levels, by precluding competition among the company's sales agents. The company is currently focused on overseas markets such as China, the United States, and Republic of Korea; of its ¥1.2 billion net sales from its own marketing efforts, 80% (or almost ¥1 billion) is generated by sales from overseas markets. Well-known European brand names—such as LOUIS VUITTON, PRADA, GUCCI, and ARMANI—now manufacture Daiichi Orimono's casual sportswear products, using the textiles produced with the company's core high-density fabric weaving technology.

Case 3: Developing and enhancing global value chains (Ichihiro Co., Ltd.)

Ichihiro Co., Ltd. (headquarters: Ehime Prefecture; number of employees: 106; capital: ¥90 million) is a towel manufacturer. The company entered the business in 1971—relatively later than other towel manufacturers in Imabari City. Since then, the company has been engaged in yarn-dyeing and towel-manufacturing. It recently acquired a wholesaler’s business, in an attempt to assist the acquired company and achieve vertical integration. As a result, the company now conducts every activity in the production line, from manufacturing to wholesale and retail. The company’s functional and beautifully designed line of products—including fashionable brand towels designed by designers both in and outside of the towel industry and embroidered handkerchiefs—are manufactured using a combination of traditional dyeing and weaving techniques and cutting-edge computer technology.

The company jointly established in 1992 a production base in Dalian, China, with a major trading firm. With the understanding that low-priced, mass-produced products would not be able to compete with those manufactured by local Chinese companies, it focused, from the beginning, on the high-mix and low-volume production of high-added-value products, such as lace and embroidered towels. Japan had been its main target market, but it recently expanded its market to Chinese urban areas, targeting primarily affluent consumers by promoting sales of high-end branded towels. The net sales of the joint venture in fiscal 2006 were over ¥3 billion.

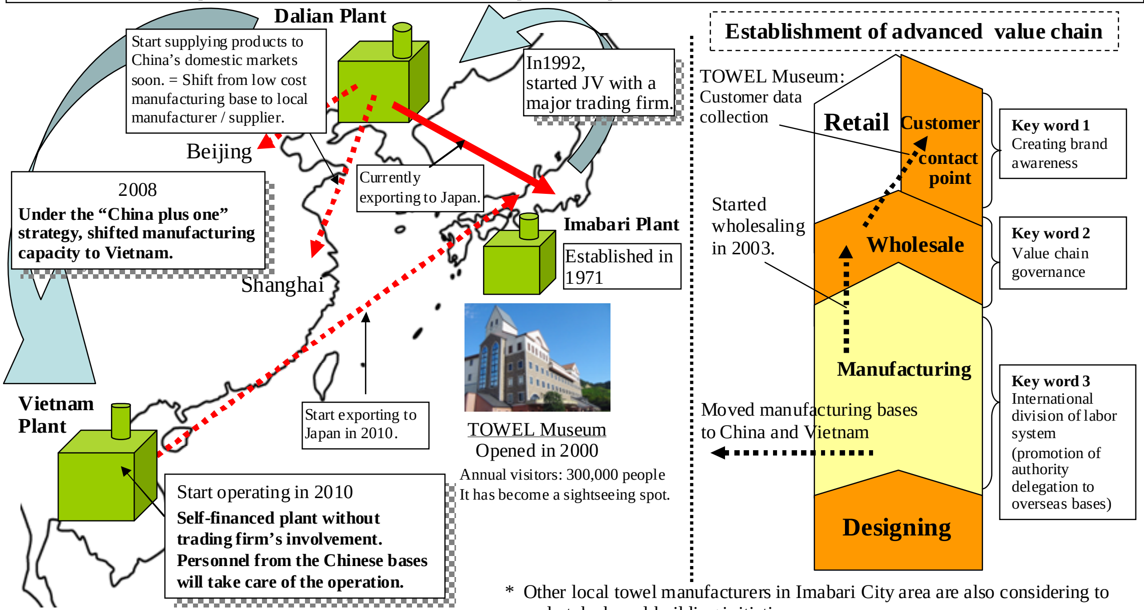
The company opened Japan’s first towel museum, called the ASAKURA Towel Museum, in 2000. It serves as a contact point with customers and as an “originating point” in the demand chain. Specifically, the company sells trial products at the Museum, and if responses are favorable, the product is mass-produced. The company has a system by which to determine consumers’ needs and quickly produce goods that fulfill those needs.

Next, the company established an overseas plant in Vietnam, but without another company’s involvement. At the new Vietnamese subsidiary established in 2005, a Chinese—who had previously served as a deputy plant manager at the Dalian plant—became President. Engineers were not sent from Japan; instead, Chinese staff members passed their skills and expertise on to Vietnamese staff members. A new business structure involving technology transfer—where technology is transferred from one overseas base to another—was established (see Figure 2-3-32).

Figure 2-3-32 An example of global value chain development led by small and medium sized enterprises

Ichihiro Co., Ltd. (former name: Ichihiro Towel Industry Co.) Founded in 1971. Capital 80 million yen. Number of employees: 226

- While maintaining the **value chain governance** by vertical integration, domestic bases specialize in design and distribution.
- To be specific, (1) **TOWEL Museum** serves as a **customer contact point**.
  (2) Implementation of business expansion to Vietnam (New plant establishment was carried out mainly by Chinese staff at Dalian Plant. Authority delegation was also promoted.
  (3) In the future, the new product supply systems are planned to be established, where products manufactured in China bases are supplied in China market, and products manufactured in Vietnam are exported to Japan.



* Other local towel manufacturers in Imabari City area are also considering to undertake brand-building initiatives.

Source: Compiled by METI.

(Promotion of strategic partnerships)

For SMEs to establish global value chains proactively, they need to form strategic partnerships with organizations such as international funds or local business partners, to supplement their weak management capacities and avoid risks that may arise from a lack of sufficient management resources. The following are some striking examples of Japanese companies that have successfully done so.

Case 1: Strategic use of foreign capital and business expansion (Nakaya Microdevices Corporation)

Nakaya Microdevices Corporation (headquarters: Oita Prefecture; number of employees: approximately 680; capital: ¥770 million) used to be a major manufacturer's subcontractor; it was heavily dependent on that major manufacturer, in terms of technology and facilities. However, in the midst of the global structural change that has recently occurred in the semiconductor industry, the company has made active efforts to participate in global value chains as a company that specializes in the post-process of semiconductor product manufacturing. To do so, the company is striving to move away from being a subcontractor and instead increase its international competitiveness[99] by taking

99 The company has said that "For a company to move away from being a subcontractor, it is important to have its own original manufacturing capability, otherwise it will remain a subcontractor" (hearing by METI).

advantage of its original manufacturing capability[100], which was created in partnership with universities and local firms.

In the increasingly globalized semiconductor industry, the ability to make prompt management decisions is essential. It is critical to a company's survival, that it quickly note overseas market trends and capture accurate information on related industry matters. Moreover, radical management decisions sometimes involve large amounts of capital investment. Taking these factors into account, in 2006, Nakaya Microdevices Corporation decided to accept capital investments from the Carlyle Group, becoming a much larger company in the process. The Carlyle Group collects and processes a wealth of information on firms and industries from around the world; it considers a combination of family-owned, unlisted companies, and foreign investment funds that work very well, since the business owner-managers on both sides share the ultimate goal of increasing corporate value. With the expectation that the Japanese semiconductor industry will experience structural changes—thus creating more opportunities for M&As—the company chose to work with the Carlyle Group, which is capable of successfully navigating large-scale M&A procedures. In addition to information collected from the Carlyle Group, the company seeks to collect more information from a wide range of sources, including banks and companies in the same business. It is now considering developing its business in Asia.

Going forward, the company intends to continue expanding its business through strategic alliances, including M&As.

Case 2: Creating new markets through active recruitment and the participation of local workers (Shigemitsu Industry Co., Ltd.)

Shigemitsu Industry Co., Ltd. (headquarters: Kumamoto Prefecture; number of employees: 64; capital: ¥10 million) manufactures fresh noodles, seasoning products, and soup products; it also operates Ajisen ramen noodle franchise restaurants. The company has been aggressively developing overseas businesses since 1996. As of February 2008, it owns 241 restaurants, primarily in China and nine other countries in the world (including 106 restaurants in Japan).

The company's overseas business is managed mainly by its Hong Kong-based partner company, which was recognized in October 2007 as the fastest-growing company in Asia, by *Business Week* (U.S.). Although the company sends staff members to assist in opening overseas restaurants, post-launch, it leaves the running of operations to local franchisees. By allowing local workers to operate the restaurants, the company can meet the needs and tastes of local consumers in terms of designing the interior, preparing menu items, and setting prices[101]. In order to maintain the same

[100] The company said that the national government's initiatives—such as the Consortium R&D Project for Regional Revitalization and the Industrial Cluster Program, the latter of which aims to help develop inter-company networks—have been helpful in increasing the company's manufacturing capabilities.

[101] Ajisen restaurants in China are generally large in size, each containing about 200 seats and serving several dozen kinds of side dishes—including yakitori, which differs from that served in Japan. The company did not insist on the strategy of serving only the one dish served in Japan; instead, it chose to flexibly meet the diverse needs of Chinese customers, who are accustomed to eating several dishes

distinct soup taste—which is key to the success of Ajisen ramen noodles and to the company's consistent and strong brand image—the company ships soup materials and periodically dispatches staff members from Japan to determine product taste. On the other hand, each franchisee in each country can independently manage side dishes. (In many cases, they serve only Japanese side dishes, in order to create the image of a Japanese restaurant.)

Going forward, the company plans to continue to develop overseas businesses actively; its target is to have 300 restaurants in China by 2010. Although the share of overseas net sales in its total net sales is at approximately 20%, the company has said that awareness of the Ajisen brand has increased due to overseas development, and subsequently attracted a significant number of customers.

(Issues to be addressed in global business development)

As seen above, while many SMEs have developed overseas businesses and enhanced their added value, many outstanding issues have been identified.

Since SMEs have limited access to management resources—such as capital, technology, and human resources—compared to large companies, they face unique challenges, such as: (1) difficulties in procuring good-quality equipment and raw materials locally; (2) difficulties in securing capable human resources; (3) technology drain; and (4) problems with the collection of accounts receivable[102].

Moreover, in METI's hearings involving companies that have withdrawn from overseas business[103], respondents indicated a number of reasons for that withdrawal, including: (1) difficulties in securing buyers/vendors[104]; (2) difficulties in managing products and production processes; and (3) troubles with local business partners. Clearly, there are many issues that need yet to be addressed in global business development[105].

(Need for support in SME global business development)

To support increasingly active SME overseas business development initiatives, the Japanese government should move forward with the implementation of measures for supplementing

together.

[102] Mitsubishi UFJ Research and Consulting, "SAIKIN NO SEIZOUGYOU WO MEGURU TORIHIKI KANKYOU HENKA NO JITTAI NI KAKARU ANKEETO CHOUSA" (conducted in November 2005).

[103] Organization for Small & Medium Enterprises and Regional Innovation, JAPAN (2006), "KAIGAI TENKAI CHUSHOU KIGYOU JITTAI CHOUSA" (conducted in March 2006) also asked SMEs questions regarding their reasons for withdrawal.

[104] According to hearings from manufacturers that have withdrawn from China—as conducted by the Japan Bank for International Cooperation (JBIC)—it was found that competition over low-added-value products is intensifying in China, and that Japanese companies need to shift their focus to higher-added-value products (JBIC, "2007 NENDO KAIGAI CHOKUSETSU TOUSHI ANKEETO CHOUSA KEKKA (DAI 19 KAI)").

[105] Other business concerns that would cause companies to withdraw include, in the case of China, (1) an increase in personnel costs, due to social security tax increases; and (2) tighter environmental regulations. With regards to personnel cost increases, in southern China in particular, the average worker's daily wage has doubled from 500 yuan to 1,000 yuan since 2003. With regards to environmental regulations, in the metal-plating industry (for example), Chinese regulations are as tight as or tighter than those in Japan. Another concern in the mid-term future is the shortage of power supply (based on hearings by METI).

management resources and improving business environment for SMEs, so that Japanese SMEs can focus on developing new markets that make use of their originality and mobility.

The specific measures that should continue to be enhanced include: (1) collection and provision of information *vis-à-vis* the systems and commercial practices of target countries (e.g., trade fairs and business-matching sessions hosted by JETRO); (2) support for hiring and training local workers (e.g., training programs provided by the Association for Overseas Technical Scholarship [AOTS] and Japan Overseas Development Corporation [JODC]); (3) improving and expanding financial sources (e.g., financing by the Japan Finance Corporation for Small and Medium Enterprise, etc., and guarantees on bank borrowings); (4) trade policy initiatives that help change the systems in target countries (e.g., utilizing EPA and investment accords); and (5) support for global branding efforts (e.g., support for enhancing added value and developing markets through the JAPAN Brand Fostering and Support Project, etc.)[106] (see Figure 2-3-33).

[106] See *Global Economic Strategy* (METI) for actual feedback from companies, etc.

Figure2-3-33 Support measures for SMEs' overseas business development

1. Support measures for overseas business development

(1) Preparation support

<u>(a) Provide information on overseas markets</u>

- Hold lectures and seminars (JETRO, etc.)
- Provide practical information on overseas business development. Introduce successful and failed cases (Small & Medium Enterprises and Regional Innovation, JAPAN [SMRJ], etc.)
- Provide information on investment procedures, economic conditions of the target countries, laws and regulations, etc. (JETRO)

<u>(b) Provide guidance on overseas business development</u>

(SMRJ [Organization for Small & Medium Enterprises and Regional Innovation, JAPAN], etc.)

<u>(c) Selection of candidate locations/ Business Feasibility Assessments</u>

(F/S study) support

- Send a survey mission including experts to target locations (SMRJ)

(1) Aftercare support

<u>(a) Provide information on local economy and systems</u>

(JETRO overseas offices)

<u>(b) Provide guidance for facilitating overseas business development</u>

(JETRO overseas offices, etc.)

<u>(c) Support for market development</u>

- Operate the website where companies from Japan and abroad can register their request items such as investment, trade, technological partnership and merger. Direct contact with registered companies via the Internet is possible. (JETRO)

<u>(d) Support for developing human resources who can contribute to the global business development</u>

- Dispatch experts on overseas business development as well as implement guidance and training programs on technical and management subjects for employees from companies operating overseas. (Japan Overseas Development Corporation [JODC], Association for Overseas Technical Scholarship [AOTS], etc.)

(d) Financial support for overseas business development

- Finance necessary funds (Japan Finance Corporation for Small and Medium Enterprise, Shoko Chukin Bank)
- Guarantee on bank borrowings for overseas business investment (Credit Guarantee Corporation), etc.

2. Export support

<u>(a) Provide information on target export markets</u>

(JETRO)

<u>(b) Provide guidance on overseas business development</u>

(JETRO)

<u>(c) Support for establishing and enhancing brand image that can compete in the global market</u>

- Support for developing and commercializing new products and services that capitalize on local strength.
- Support for community initiatives aimed at building JAPAN Brand.

<u>(d) Support for market development</u>

- Support for participation in overseas trade fairs/exhibitions (JETRO, etc.)

<u>(e) Trade and investment insurance</u>

(Nippon Export and Investment Insurance [NEXI])

3. Support for business partnership with foreign companies

<u>(a) Hold lectures, trade fairs, exhibitions, and business meetings</u>

(JETRO)

<u>(b) Support for market development</u>

(JETRO)

<u>(c) Support for overseas business development by regional group of SMEs</u>

- Implement industrial exchange programs between SME cluster areas in Japan and abroad. (JETRO)

Source: Small and Medium Enterprise Agency (2008) "*We support your global business development*."

[Column 13] Quality control: A unique challenge to SMEs[107]

One of the major challenges in overseas production that is unique to SMEs is the obstacle of quality control, which is much less challenging for large companies.

While large companies mass-produce standardized products using large-scale facilities, in many cases, the skilled workers at SMEs skillfully operate special facilities to produce original products in small lots. For this reason, it is more necessary for SMEs to train and educate local workers, to help improve their skills, than is the case with large companies.

In fact, there have been cases where a lack of skills among untrained workers has resulted in substantially lower-than-planned production levels. For example, in China, a medium-sized insulation material manufacturer has not been able to produce products that meet quality requirements, because the local workers have not been properly trained. The manufacture of insulation requires the mastery of detailed skills, such as the control of raw material input volume and temperature adjustment; although Japanese staff members have been dispatched to provide technical training for local workers and thus help improve and maintain product quality, many challenges remain.

[Column 14] Accounts receivable collection and the example of a foreign servicer performing the function of an "external business division"

Some companies have had challenges in collecting accounts receivable and payments from overseas customers. According to a survey conducted by JETRO in 2002, 75.3% of the responding companies said receivables collection was a major problem in China.

A lack of credit information on prospective customers—due to an unavailability of local information—makes it difficult to screen potentially good customers. As a result, overdue payments become a problem.

In such circumstances, foreign companies have started to provide accounts receivable collection services, as an alternative to taking immediate legal action. For example, ABC-amega (U.S.) provides payment collection services for its customers. The company's staff members negotiate directly with executives of the paying companies (i.e., the president and/or general manager in charge of finances) and collect payments. However, Japanese SMEs are not fully utilizing this type of service, for a number of reasons: (1) not many Japanese companies provide this kind of service; (2) even when companies wish to use such foreign servicers, they tend not to have a branch or office in Japan; and (3) communication in English is difficult when using foreign servicers. It is desirable for payment collectors to become established and developed in Japan, taking into consideration the provision of article 72 of the Lawyer Law, which forbids legal practices by parties other than lawyers and legal-profession corporations.

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107 METI (2008), *White Paper on Small and Medium Enterprises in Japan 2008*. Japan Finance Corporation for Small and Medium Enterprise, "DAI 8 KAI CHUGOKU SINSHUTSU CHUSHOU KIGYOU JITTAI CHOUSA" and "DAI 12 KAI ASEAN SINSHUTSU KIGYOU NO JITTAI CHOUSA" also provide detailed information on the conditions of SMEs that operate overseas.